

**ADMINISTRATION'S FISCAL YEAR 1987 BUDGET
PROPOSALS RELATING TO THE INTERNAL REVE-
NUE SERVICE**

HEARING
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
OF THE
COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES
NINETY-NINTH CONGRESS
SECOND SESSION

MAY 12, 1986

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ADMINISTRATION'S FISCAL YEAR 1987 BUDGET PROPOSALS RELATING TO THE INTERNAL REVENUE SERVICE

MONDAY, MAY 12, 1986

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to call, at 9 a.m., in room B-318, Rayburn House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

[The press release announcing the hearing follows:]

FOR IMMEDIATE RELEASE
THURSDAY, MAY 1, 1986

PRESS RELEASE #20
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1105 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D. C. 20515
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THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN,
SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS,
U.S. HOUSE OF REPRESENTATIVES,
ANNOUNCES A HEARING

TO CONSIDER THE ADMINISTRATION'S FISCAL YEAR 1987
BUDGET PROPOSALS RELATING TO THE INTERNAL REVENUE SERVICE

The Honorable J. J. Pickle (D., Texas), Chairman, Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will hold a hearing to examine the Administration's fiscal year 1987 budget proposals relating to the staffing levels and allocation of resources of the Internal Revenue Service. The Subcommittee also will review the pending FY 1986 supplemental appropriation request, the impact of the Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings) on IRS, the current status of IRS's computer system and its computer modernization plans, and the current filing season. The hearing will be held on Monday, May 12, 1986, in Room B-318 Rayburn House Office Building, beginning at 9:00 a.m.

Witnesses invited to appear at the hearing include the Internal Revenue Service; the U.S. General Accounting Office; former IRS Commissioners Jerome Kurtz, Donald Alexander and Sheldon Cohen; the American Bar Association; the American Institute of Certified Public Accountants; and the National Treasury Employees Union.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:

Persons desiring to present a written statement for the printed record of the hearing should submit at least six (6) copies, by the close of business, Monday, May 19, 1986, to Joseph K. Dowley, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D. C. 20515.

If those filing written statements for the printed record of the hearing wish to have their statements distributed to the press and the interested public, they may provide 150 additional copies for this purpose to the Subcommittee office, 1105 Longworth House Office Building, before the hearing begins.

FORMATTING REQUIREMENTS FOR HEARING STATEMENTS AND EXHIBITS:

Each statement presented by a witness or any written statement or exhibit submitted for the printed record of the hearing must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be included in the printed hearing record, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for the printed hearing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. Statements must contain the name and capacity in which the witness will appear, as well as any clients or persons, or any organization for whom the witness appears.
4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or a designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record of the hearing.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted only for distribution to the Members, the press and public, may be submitted in other forms.

Chairman PICKLE. The subcommittee will come to order.

Once again, the Subcommittee on Oversight is conducting a hearing to examine the adequacy of the administration's proposed budget for the Internal Revenue Service. This subcommittee, in conjunction with the full Committee on Ways and Means, and the Appropriations Committee, seeks to ensure that the Internal Revenue Service is properly managed and given the resources it needs to adequately administer the tax laws.

More than any other Federal agency, the Internal Revenue Service affects the life of each and every U.S. citizen. Accordingly, it is important that our tax laws be administered fairly and in a timely manner. All this hinges on the ability of the Internal Revenue Service to function efficiently and effectively.

Today, we intend to examine the fiscal year 1987 budget of the Internal Revenue Service to determine (1) where the proposed budget falls short of what the Nation's taxpaying public deserves, and (2) where the proposed budget is, at the very least, an improvement over prior years.

As the members of this subcommittee can attest, the sorting out of exactly what the Internal Revenue Service needs is not an easy task. The Internal Revenue Service role ranges from returns processing, examination, collection and appeals to taxpayer service, issuance of regulations, rulings, and tax information publications—and even debt collection. All these activities require well-trained personnel and up-to-date, reliable equipment. Indiscriminately throwing more dollars at the Internal Revenue Service is clearly not the right answer. The Internal Revenue Service needs a balanced and well-managed program.

After years of subcommittee review of Internal Revenue Service budgets, I hope today that we will learn that the Office of Management and Budget more clearly recognizes the unique role of the Internal Revenue Service. An efficient Internal Revenue Service is to everyone's advantage, both from a revenue collecting standpoint and from a fairness standpoint. This administration and others have repeatedly turned a deaf ear to their own Internal Revenue Service Commissioners' pleas for adequate resources. I hope that last year's events and our numerous hearings with former Commissioner Egger, have had a positive impact on the Office of Management and Budget's awareness of the importance of a healthy Internal Revenue Service.

Finally, I should note that I have asked that Internal Revenue Service and other witnesses to briefly discuss the status of the fiscal year 1986 emergency supplemental request and its impact, Internal Revenue Service progress in processing 1985 tax returns, and Internal Revenue Service computer modernization plans. I look forward to their testimony.

We have a distinguished group of witnesses today, so let us begin.

Mr. Schulze, would you care to make a statement?

Mr. SCHULZE. Thank you, Mr. Chairman.

Mr. Chairman, I do appreciate your calling this hearing and continuing this Subcommittee on Oversight review of the matter.

This subcommittee has spent considerable time during the last several years visiting Internal Revenue Service centers and study-

ing Internal Revenue Service data processing systems and procedures. Needless to say, the allocation of resources to Internal Revenue Service functions is one fact that will affect how well the Internal Revenue Service performs its job, how it is viewed by the tax-paying public, and also how well the voluntary compliance aspects of our tax system will operate.

I am deeply concerned that taxpayers be able to obtain prompt and high quality responses from the Internal Revenue Service, but I am unwilling to merely accept on faith that throwing additional funding into the Internal Revenue Service will solve anything. Funding of the Internal Revenue Service comes from taxpayers, and I intend to do my part to see that the taxpayers money is spent wisely.

The Service spends a great deal of—\$4.1 billion—of the budget for fiscal year 1987, including some substantial amounts for increasing personnel and updating computers. It is necessary that the manner in which Internal Revenue Service funding is actually spent during 1987 produce real efficiency gains. In this regard, I certainly hope that the witnesses today are prepared to discuss specific recommendations which will achieve that goal.

Finally, I would like to welcome Acting Internal Revenue Service Commissioner Jim Owens in his first appearance before our committee in his new capacity.

Thank you, Mr. Chairman.

Chairman PICKLE. Thank you.

Mr. Dorgan, do you have a statement?

Mr. DORGAN. Mr. Chairman, I would ask that my statement be inserted in the record at this point.

[Mr. Dorgan's statement follows:]

STATEMENT OF HON. BYRON L. DORGAN, A REPRESENTATIVE IN CONGRESS FROM THE
STATE OF NORTH DAKOTA

Mr. Chairman, I appreciate your holding these hearings on the Administration's fiscal year 1987 budget relating to the Internal Revenue Service and I am happy to assist you in co-chairing these hearings.

In a time when this country faces record deficits, we have justifiably spent a great deal of time and energy seeking means to reduce expenses. But, cutting expenses is only one aspect of the solution to our deficit problems. We must also be certain that each of our citizens and businesses are paying their share of the tax burdens.

While the vast majority of the American citizens continue to voluntarily pay their taxes, compliance has dropped nationally from 94 percent in 1965 to 81.6 percent in 1985. This translates into \$100 billion in lost revenue annually. When we have over 80 percent of the country assuming the responsibility for our necessary expenditures, we have a duty to aggressively pursue the nearly 20 percent who ignore our tax laws.

The Internal Revenue Service records now reflect over \$45 billion in accounts receivable alone. This is money that we know is owed yet we have been unable to collect. If we were only to collect these funds, we would be taking a significant step toward solving our budget problems.

While the President's budget proposal calls for increases both in staff and funds for the IRS, I think we need to be certain that these increases are sufficient. Over the past decade IRS audits have decreased by a full 50 percent. If we do not provide the IRS with the necessary funds for proper enforcement of our tax laws, we are, in effect, inviting tax evasion.

Through my more than ten years as state tax commissioner I have come to recognize the importance of tax enforcement. In 1982, North Dakota invested \$963,000 in the tax department for enforcement allowing the number of audits to double. This has paid off in \$14 million in additional revenue over the next two years. In Massachusetts, Governor Dukakis and Commissioner Ira Jackson have invested significant

funds and energy in their Department of Revenue. As a result, total revenue collections have grown by 28.7 percent and voluntary compliance has increased by \$564 million over the past two years.

Once again, Mr. Chairman, thank you for calling these hearings. I hope that through our work today we are able to ensure that the IRS receives the critical funding it needs to dramatically improve tax enforcement and voluntary compliance by all of our taxpayers.

Mr. DORGAN. I would say that Mr. Schulze is correct. The issue of what we spend for our tax collection functions is very important, but I might also say this: At a time when we have record Federal deficits, to have accounts receivable of nearly \$45 billion at the Internal Revenue Service and to have uncollected taxes of nearly \$100 billion a year represents some pretty serious problems in our tax collection function. I think it is important for us to understand that we may need to invest some more money in our tax collection system that will yield dividends.

We can't continue a system that has a collection ratio of somewhere around 80 percent of what it ought to collect and has accounts receivable of \$45 billion and see the base of the tax collection system be eroding over a number of years. We have got to solve that problem. I hope this hearing will shed light on how we solve the problem.

Chairman PICKLE. Thank you, Mr. Dorgan.

Now, our first witness this morning is the Hon. James Owens, who is Acting Commissioner of Internal Revenue.

We are glad to have you here, Mr. Owens. We have enjoyed working with you now for several years and you are a very efficient and recognized leader in your field. Before you proceed, can you give us any insight on who will be the next Commissioner of Internal Revenue?

STATEMENT OF HON. JAMES I. OWENS, ACTING COMMISSIONER OF INTERNAL REVENUE, ACCOMPANIED BY M. EDDIE HEIRONIMUS, ASSOCIATE COMMISSIONER OF DATA PROCESSING; STEVE TAYLOR, FISCAL BUDGET OFFICER; AND TOM E. PERSKY, LEGISLATIVE LIAISON

Mr. OWENS. I thought that maybe I would get that from this committee, Mr. Chairman. I can't offer anything except what has been in the newspapers.

Chairman PICKLE. We are glad to have you.

Mr. OWENS. Thank you, Mr. Chairman.

I appreciate the opportunity to appear before you today to discuss the budget requirements of the Internal Revenue Service. In my testimony, I will discuss the highlights of our fiscal year 1986 supplemental budget request and our fiscal year 1987 budget, both of which are now pending with Congress.

With me are a number of senior Internal Revenue Service officials, all of whom will be available to respond to any questions you or the members may have at the conclusion of my testimony.

FISCAL YEAR 1986 BUDGET SUPPLEMENTAL

On February 5, 1986, the administration forwarded to the Congress a \$340 million supplemental budget request for the Internal Revenue Service. In large measure, this request was necessary in

order to address the problems and deficiencies that were identified during last year's very difficult tax processing season. Because decisions affecting the 1986 filing season could not be delayed pending congressional action on the supplemental, the Service—with the concurrence of Treasury and the Office of Management and Budget—has spent resources based on the assumption that the \$340 million supplemental will be forthcoming. The administration has notified the congressional leadership of the urgency of this situation and has provided the formal notification of a fourth quarter deficiency for the Internal Revenue Service.

The decision to operate the Service at a level that assumed passage of the supplemental has narrowed the options to deal with a possible shortfall. However, the decision to spend at a level that permitted a successful filing season was the correct one. Neither the agency nor the tax administration system as a whole could run the risk of a repeat of the difficulties of 1985.

In fact, the 1986 filing season has been extremely successful. Faced with a record number of returns, we processed those returns and issued refunds at record rates. The hardware, software, operational, and training initiatives have paid off. Despite the fact taxpayers are filing later and later in the filing season—and giving us less time to process returns—we expect to pay millions of dollars less in interest on late refunds than we paid in 1985. At the same time, significant progress has been made in reducing a number of problem inventories in the centers. While some problems still remain, the year to year comparison is remarkable.

As of May 2, current service center receipts were 94.4 million returns; last year's receipts for the same period were 94.6 million. Also as of May 2, the service centers have processed 68.2 million returns, up from last year's figure of 62.1 million. The National Computer Center has certified 55.5 million refunds, 10 percent more than the 50.4 million at that time last year. This year's average refund is \$843; last year's average was \$794.

During the filing season, computed through May 2, we answered some 19.9 million calls through our toll-free telephone system and 5.1 million calls through our multifunctional equipment. Our statistics indicate that slightly more than 80 percent of all taxpayers were able to reach us on the first attempt during the filing period.

This success of the 1986 filing season was made possible by assuming the passage of the supplemental and conducting our programs consistent with that assumption. Specifically, the principal provisions of the supplemental are as follows:

RESTORE EFFECTIVENESS TO TAX PROCESSING

The major part of this supplemental request, 5,558 positions and \$140 million, is required to overcome deficiencies in our tax processing system and restore it to full effectiveness. With these resources, we are:

Implementing more realistic production rates in our 10 service centers; improving the quality of processing operations across the board by enhancing review of taxpayer notices before they are issued; improving management oversight; enhancing quality control; increasing key verification of tax return data; stepping up the

monitoring and control of refund returns; increasing computer room staffing; and adding resources to deal with the high levels of certain problem inventories in the service centers.

IMPROVE TAXPAYER SERVICE

An additional 670 positions and \$41 million were necessary to keep pace with the increased demands of taxpayers for assistance. This request includes funds to cover toll free telephone circuitry and to begin phasing in the capability for on-line, immediate tax account adjustments.

MAINTAIN TAX ADMINISTRATION AND ESTIMATED REVENUES

An essential part of this supplemental is the funding of certain basic costs of doing business. I will mention five items here: First, additional resources of \$42 million are required to cover mandatory cost increases for items such as rent and telephone charges.

Second, as will be more fully discussed later, the administration is proposing a major revenue initiative that will recover significant tax revenue currently going unreported. For fiscal year 1986, 332 positions and \$14.5 million will enable us to begin hiring and training agents for this initiative. In the same manner, supplemental resources of 63 positions and \$2.7 million are needed to step up the resolution of tax shelter cases.

Third, so that we can process the dramatically increased volume of currency and cash transaction reports, an additional 255 positions and \$6.1 million are required. These documents are used by law enforcement agencies and are a key element in combating organized crime and drug trafficking.

Fourth, supplemental funding of \$72 million is critically needed to prevent severe staffing reductions this year in our enforcement functions, and thus to ensure Federal revenue receipts planned for fiscal year 1986.

And fifth, with respect to other enforcement items, our request includes \$3.6 million to improve enforcement training, \$14.8 million for enforcement related ADP needs, and 72 positions and \$3 million to increase examination of domestic corporations engaging in international activities.

CURRENT FISCAL YEAR 1986 SPENDING STATUS

The Service has never had a more critical budget need than that represented by the fiscal year 1986 supplemental request. The successful, uninterrupted operation of the Internal Revenue Service this fiscal year depends on this supplemental being fully appropriated.

We have been working with the Treasury Department and the Office of Management and Budget to develop contingency actions that we must take if the supplemental appropriation is delayed or not approved. In this development we will make every effort to select actions which will have the least negative permanent effect. However, as time goes on, little flexibility remains.

In an April 30 letter to congressional leadership Secretary Baker reemphasized the critical nature of this supplemental request and

identified a series of potential deferrals and reductions that the Service may be called upon to make over the next few months. The Service has already found it necessary to take a number of specific actions including: Deferring the advance hiring necessary for the revenue and tax shelter initiatives in examination and appeals; postponing the planned increase in examination of multinational corporations; deferring the plan to equip the service centers with an uninterruptible power system; discontinue overtime in operations not directly involved in or directly supporting tax processing operations; deferring acquisition of supplies, services, and office equipment except in cases where legally enforceable contractual obligations exist; deferring permanent hiring commitments for technical employees in examination, collection, and taxpayer service; and deferring acquisition of ADP services and equipment except in cases where legally enforceable contractual obligations exist; restrict purchases of ADP supplies to the minimal practical level to support ongoing operations.

While all these actions will have significant adverse effect on the operations of the Service, they represent those actions which will have the least permanent effects on operations and Federal revenues. Depending upon developments in the Senate, the Service will on May 22 release as many as 6,000 temporary employees in examination, collection, and taxpayer service, and cut case-related travel by 50 percent.

FISCAL YEAR 1987 BUDGET REQUEST

Turning to issues beyond this fiscal year, the Internal Revenue Service budget request for fiscal year 1987 is in keeping with the goal of limiting Federal expenditures while recognizing the Internal Revenue Service's special role in raising the revenue necessary to reduce Federal budget deficits. In fiscal year 1987, Internal Revenue Service will collect \$800 billion in tax revenues—over 90 percent of all Federal revenues.

The Internal Revenue Service has requested an appropriation of 95,084 positions and \$4.1 billion, an overall increase of 1,360 positions and \$272 million over the fiscal year 1986 proposed level. The total Internal Revenue Service budget is divided into four appropriation accounts. These accounts are salaries and expenses; processing tax returns; examination and appeals; and investigation, collection, and taxpayer service.

The salaries and expenses appropriation provides funding for policy formulation and executive direction of the Internal Revenue Service, for management services, and for the centralized direction of activities which perform independent reviews of operations and protect the integrity of the Service. Requested resources for the salaries and expenses appropriation total 2,044 average positions and \$95.1 million, a decrease of 27 average positions and an increase of \$5.2 million from the revised fiscal year 1986 level.

The processing tax returns appropriation provides funding for two activities: returns processing and revenue accounting, and computer services. The budget proposed for the processing tax returns appropriation totals 27,327 average positions and \$1,262.9 million a

net decrease of 1,617 average positions and an increase of \$49.1 million over fiscal year 1986.

The examination and appeals appropriation provides funding for three activities: examination, appeals and tax litigation, and employee plans and exempt organizations. The budget proposed for the three activities financed in the examination and appeals appropriation totals 38,974 average positions and \$1,603.2 million, a net increase of 3,051 average positions and \$176.0 million over fiscal year 1986.

The investigation, collection and taxpayer service appropriation provides funding for four activities: tax fraud investigations, collection, taxpayer service and enforcement litigation and rulings. The budget proposed for the four activities financed in the investigation, collection, and taxpayer service appropriation totals 26,739 average positions and \$1,136.6 million, a decrease of 47 average positions and an increase of \$41.3 million over the fiscal year 1986 level.

The fiscal year 1987 budget also contains the following principal initiatives:

REVENUE INITIATIVES FOR FISCAL YEARS 1987-89

This request includes an increase of 2,500 positions and \$94.4 million for the first full year of a major revenue initiative. Under this initiative, we will add 2,500 positions each year for a period of 3 years—fiscal years 1987 through 1989—to examine additional tax returns. The result will be to increase revenue collections by \$4.7 billion during the 3-year period. By retaining these resources in fiscal years 1990 and 1991, we will collect an additional \$5.6 billion for a total revenue gain of \$10.3 billion.

DOCUMENT MATCHING INITIATIVE

An additional 795 positions and \$21 million are requested to expand the Information Returns Program. Under this Document Matching Program, the service matches information returns, such as wage, interest and dividend statements with the related income tax returns. With the requested resources, the Service will contact more taxpayers to determine the reasons for the mismatch of information. Also, the Service will expand its program to correct erroneous taxpayer identification numbers. Additional revenue collected in fiscal year 1987 from this initiative should total \$167 million.

TAX SHELTER INITIATIVE

To expedite resolution of tax shelter cases backlogged in administrative appeal and tax litigation, we have requested 465 positions and \$20.6 million. This initiative is needed to help reduce the number of tax shelter cases—representing some 372,000 returns—now in inventory within examination. These cases will be proceeding to the administrative appeals and tax court dockets within the next few months. This initiative will accelerate the collection of tax revenues by some \$600 million in fiscal year 1987.

ADP AND SYSTEMS MODERNIZATION

This portion of our fiscal year 1987 request includes 82 positions and \$51.8 million to continue implementation of ADP modernization projects begun in prior years. For example, we will continue the fully implemented automated collection system, which has streamlined our office collection function and accelerated revenue collections. Under the automated examination system, we will provide portable computers to all revenue agents. We also will implement several key enhancements to our highly automated document matching program. Finally, we will continue to pilot such projects as electronic filing and laser storage of tax return data.

MAINTAIN TAX ADMINISTRATION

Resources totaling \$84 million are needed to cover mandatory cost and workload increases. This is a net requirement after subtracting certain nonrecurring costs from the prior year. In fiscal year 1987, we will process 3.5 million more tax returns and supplemental documents, maintain our commitment to the President's Task Forces on Organized Crime and Drug Enforcement, and provide tax law and account assistance to 65 million taxpayers through direct assistance or taxpayer education.

ORGANIZED CRIME AND DRUG ENFORCEMENT

Once again, the Internal Revenue Service will contribute substantial resources to combating organized crime and drug abuse. In fiscal year 1987, we will devote over 1,300 positions and \$61 million to drug enforcement alone. The Internal Revenue Service contributes 442 positions, over half the resources spent by Treasury on the President's Task Forces on Organized Crime and Drug Enforcement. Since the inception of this effort, the Internal Revenue Service has participated in two out of every three cases—a level second only to the Drug Enforcement administration. Some 1,050 indictments and 657 convictions have already been made. In addition, the Internal Revenue Service contributes resources to the multi-agency strike forces which combat organized crime.

Finally, the Internal Revenue Service is responsible for processing currency reports required under the Bank Secrecy Act. In this area, we have experienced a 350-percent increase in filings, from 500,000 reports filed in 1983 to 1,832,000 in 1985.

Finally, in response to your specific request, I am providing information on how the Internal Revenue Service would allocate additional staffing and funding, including yield to cost ratios; and a breakdown of staffing levels, funding levels and projected receipts as set forth in the Internal Revenue Service budget submission to Treasury and the Treasury submission to the Office of Management and Budget and the final administration submission to Congress.

GRAMM-RUDMAN-HOLLINGS

In fiscal year 1986 the Internal Revenue Service operating budget, along with other agencies, was cut by 4.3 percent under the

Gramm-Rudman-Hollings legislation. In our case, this amounted to \$157 million.

At this time, we are unable to predict what impact Gramm-Rudman-Hollings will have for fiscal year 1987. The President's budget request meets the deficit reduction target required under the Balanced Budget and Emergency Deficit Control Act of 1985. However, if a Gramm-Rudman-Hollings sequestration becomes necessary, the Internal Revenue Service is not exempt. As you know, these cutbacks make no distinction between agencies that produce revenue and agencies that spend revenue.

SUMMARY

Again, I appreciate the opportunity to discuss the Internal Revenue Service fiscal years 1986 and 1987 budget needs, and my colleagues and I will be pleased to try and answer any questions you or the members may have.

I might add, Mr. Chairman, there are several attachments to my statement which I would appreciate being entered into the record. [Attachments to the statement follow:]

INTERNAL REVENUE SERVICE
HIGHLIGHTS OF THE FY 1987 PRESIDENT'S BUDGET

IRS Budget

The IRS operating budget for FY 1987 totals 95,084 positions (full-time equivalency, excluding 763 reimbursable positions) and \$4,097.8 million -- proposed increase of 1,360 positions and \$271.7 million over FY 1986.

Fiscal Year 1986

The IRS appropriation, as approved by the Congress in the Continuing Resolution (P.L. 99-190), totals 86,774 positions and \$3,642.8 million. Adjustments are proposed through a program supplemental and a reduction (sequestering of funds) as follows:

(1) Program Supplemental: 6,950 positions and \$340 million:

- restore the effectiveness of tax processing (process tax returns accurately, issue refunds timely, maintain tax accounts through improved taxpayer correspondence and adjustment capability) 5,558 positions and \$140.2 million;
- improve responsiveness to the public (expand taxpayer service) 670 positions and \$40.8 million;
- strengthen tax enforcement (examine tax returns, collect unpaid taxes, secure delinquent returns, match information documents, process currency and cash transaction reports, settle administrative appeals, litigate tax cases) 722 positions and \$116.8 million;
- meet costs to stay in business (rent of space, employee relocation expenses, toll-free telephone circuitry) \$42.2 million.

(2) Reduction under Gramm - Rudman - Hollings: \$156.6 million.

The Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm - Rudman - Hollings), P.L. 99-177, requires reductions, through sequestering of funds already approved, of \$11.7 billion governmentwide --

HIGHLIGHTS OF THE FY 1987 PRESIDENT'S BUDGET

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with reductions of 4.9% to defense and 4.3% to domestic spending. Under this act, the IRS operating budget is being cut by \$156.6 million (4.3%). IRS expects that the reduction can be achieved by cutting administrative and support costs (supplies, office equipment, contracts, etc.), and selected ADP and systems modernization expenditures. It is expected that direct tax filing operations (tax return processing, taxpayer service) and direct revenue-producing programs will not be curtailed.

The revised level for FY 1986, with the above adjustments, is 93,724 positions and \$3,826.2 million for four operating appropriations.

Fiscal Year 1987

In keeping with the Administration's goal of reducing the federal budget deficit and in recognition of the need to collect tax revenues which are owed under current law, the IRS proposes an appropriation level of 95,084 positions and \$4,097.8 million -- an increase of 1,360 positions and \$271.6 million as follows:

- increase examination of tax returns by adding 2,500 positions and \$94 million each year over the next three years, for a revenue gain of \$10 billion (FY 1987 - 1991);
- expand document matching with emphasis on correcting erroneous taxpayer identification numbers and follow-up on returns with apparent underreported income, with additional revenue collected of \$167 million in FY 1987 (795 positions and \$21 million);
- expedite resolution of tax shelter cases backlogged in administrative appeal and tax litigation, thus accelerating collection of revenues by \$600 million in FY 1987 (465 positions and \$20.6 million);
- continue implementation of ADP and systems modernization initiatives begun in prior years to enhance tax enforcement and tax processing (82 positions and \$51.8 million).

Within the overall budget of 95,084 positions and \$4,097.8 million, the Internal Revenue Service will:

HIGHLIGHTS OF THE FY 1987 PRESIDENT'S BUDGET

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- collect some \$800 billion in tax revenues (net after refunds); \$38 billion will result from direct enforcement of the tax laws (i.e., examining tax returns, collecting unpaid taxes, securing delinquent returns, and matching information reports);
- process 180 million tax returns and issue 80 million refunds, including three million additional returns which result from higher employment;
- assist 65 million taxpayers through direct assistance, including toll-free telephone service and taxpayer education;
- continue to augment examination of domestic corporations having international activity.

IRS Operating Accounts - Resource Summary

	<u>Average Positions</u>	<u>Amount (millions)</u>
FY 1985 Appropriation	92,259	\$ 3,574.1
FY 1986 Continuing Resolution		
Adjusted by:	86,774	\$ 3,642.8
Sequestering of funds required by the Balanced Budget and Emergency Deficit Control Act of 1985 (P.L. 99-177)	--	-\$ 156.6

Supplemental Proposed:

Restore effectiveness of tax processing	+ 5,558	+\$ 140.2
Improve responsiveness to the public	+ 670	+\$ 40.8
Strengthen tax enforcement	+ 722	+\$ 116.8
Meet costs to stay in business	--	+\$ 42.2
Proposed FY 1986 Level	93,724	\$ 3,826.2

FY 1987 Adjustments:

Mandatory cost and workload increases	+ 628	+\$ 307.0
Nonrecurring costs	- 3,110	-\$ 223.2
ADP program increases	+ 82	+\$ 51.8

HIGHLIGHTS OF THE FY 1987 PRESIDENT'S BUDGET

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	<u>Average Positions</u>	<u>Amount (millions)</u>
Revenue initiative	+ 2,500	+\$ 94.4
Tax shelter initiative	+ 465	+\$ 20.6
Document matching initiative	+ 795	+\$ 21.0
FY 1987 Budget Request	95,084	\$ 4,097.8
Difference, FY 1987 compared to the FY 1986 proposed level	+ 1,360	+\$ 271.6

IRS Operating and Payment Accounts (FY 1987)

Salaries and Expenses: \$ 95.1 million, up \$ 5.2 million
 Processing Tax Returns: \$1,262.9 million, up \$ 49.1 million
 Examination and Appeals: \$1,603.2 million, up \$176.0 million
 Investigation, Collection
 and Taxpayer Service: \$1,136.6 million, up \$ 41.3 million

Total, IRS Operating
 Accounts: \$4,097.8 million, up \$271.7 million

In addition to operating costs, funds are also included
 in the President's budget to:

- pay credits to individuals who earn less than
\$11,000 (\$1,228 million, down \$55 million);
- pay interest on refunds of IRS collections
(\$1,473 million, down \$29 million);
- repay Puerto Rico for taxes collected
(\$245 million, up \$10.5 million). This outlay
account is subject to sequestering under P.L.
99-177; (\$10.5 million is being cut in FY 1986);
- redeem real property when advantageous to cover
delinquent taxes (\$10 million authority, no increase or
decrease in FY 1987).

Total, IRS Payment
 Accounts: \$2,946.0 million, down \$ 73.5 million

Grand Total: \$7,043.8 million, up \$198.2 million

D. A. O'Brien
 PM:PFR:F:B
 2-4-86

INTERNAL REVENUE SERVICE
FY 1986 CURRENT FINANCIAL CONDITION
AND CONTINGENCY PLANS

Anticipated FY 1986 budget availability for the Internal Revenue Service totals \$3.826 billion. This budget level consists of the following:

- funds appropriated by the continuing resolution totaling \$3.643 billion
- Gramm-Rudman-Hollings reduction of \$157 million
- Supplemental budget request totaling \$340 million, consisting of \$140 million for tax processing operations, \$41 million for taxpayer service, \$117 million to maintain enforcement programs and revenue forecasts and to begin advance hiring, and finally, \$42 million to cover mandatory operating costs.

Expenditure Restrictions Already in Effect

The G-R-H reduction to the Service's budget base in January required sharp reductions in a variety of expenditure categories. In January the Service directed its national office and regional managers to begin cutting expenditures with the understanding that all efforts would be made to protect the Service's commitment to assure a smooth filing season and maintain direct revenue producing programs and thus revenue receipts assumed in Treasury estimates.

Cutback measures that have been in effect since January 28 include:

- a complete hiring freeze in all offices and functions excepting only front-line returns processing, taxpayer service, collection and examination operations
- reduction to temporary employment and overtime in nonfront-line programs
- curtailment of non-case travel (e.g. oversight, task forces, conferences, etc.)
- deferral of discretionary training programs
- reduction to equipment, supplies, and services acquisitions
- scaling back of space alterations not specifically essential to filing season needs
- reduction of ADP expenditures

New Requirements in Tax Processing

The Service is experiencing a higher resource need to complete this filing season than proposed budget levels provide for. While still being reviewed, current estimates total about 1,700 additional staff years. The principal reasons for this additional need include:

- training requirements were higher than expected (in some service centers the proportion of inexperienced staff to total is unprecedentedly high)
- quality initiatives were more costly than anticipated
- work volumes continue to exceed planned levels in service center branches handling taxpayer relations, underreporter issues, and adjustments and correspondence

The Service must find sources of funding within its availability to cover this additional need in the service centers during the balance of the year. This process is under way and will require that regions and the national office make further cuts in travel, training, and support programs. This will place added pressure on the FY 1987 budget to make up essential cost deferrals. Also, and very importantly, this further reduces the Service's ability to accommodate any unfavorable or late action on the supplemental without cutting essential revenue sensitive operations.

The Supplemental and Contingency Plans

Of critical importance to the Service are (1) appropriation of the full supplemental and (2) that it be enacted soon. The nature of the supplemental (e.g. filing season operations, maintenance of planned revenue program levels, and mandatory costs) have made it necessary for the Service to spend in anticipation of virtually the entire amount of the supplemental. Only some \$30 million, representing principally fourth quarter revenue initiative and tax shelter initiative advance hiring, remains uncommitted.

The need to apply additional resources in our ten service centers this filing season, while, at the same time, reducing spending under Gramm-Rudman-Hollings, has put us in a very restrictive financial posture. The fiscal year is more than half over. The options available are extremely limited, recognizing the need for order in scaling back operations. If the Service does not take the necessary steps now and supplemental resources are not forthcoming, we will exhaust appropriated funds in August. We have no responsible choice but to begin curtailing operations if there is no clear indication of favorable action on the supplemental within the next two weeks. Status and assumptions in laying out reduction plans are as follows:

- The House Appropriations Committee reported the urgent supplemental appropriations bill on March 25. The bill includes our full request for \$340 million plus 5% interappropriation transfer authority and transfer authority for increased pay costs. There is still serious uncertainty regarding congressional action -- both as to timeliness and amount. (We will need to reinforce the importance of the supplemental with the Senate Committee when they take up the House bill.)
- Failing timely and favorable congressional action on the \$340 million and the transfer authority, the Service will begin within two weeks appropriate curtailment of operations and expenditures. The timing and nature of cutback actions will be based on the goal of minimizing the extent of furlough of IRS's permanent workforce.
- Should veto occur, any Presidential veto message must strongly emphasize to Congress the continued and immediate necessity of the IRS supplemental.
- Drastic cutback measures, once taken, cannot be recouped. Substantial damage would occur to tax processing; collection of tax revenues would fall, with an estimated loss of over \$4 billion in receipts; and infusion of more resources would be needed to begin recovery efforts next year.

The cutback actions that the Service must begin taking -- barring immediate, positive indications of supplemental enactment -- are as follows:

- 4 -

(Amounts in Millions)

AMOUNT
SAVEDACTIONIN APRIL 1986

- \$ 17 • delay advance hiring of revenue agents for approved revenue initiative and needed improvements in training. Loss of productivity in FY 1987 will result in fewer examinations and less revenue;
- \$ 3 • defer initiative to resolve tax shelter cases now backlogged in inventory, thus delaying revenue collections in FY 1987;
- \$ 3 • delay augmenting staff to examine multinational corporations (unitary tax).
- \$ 7 • delay installation of uninterruptible power sources in service centers. Next year's filing season could be jeopardized by lack of adequate power sources to operate computers and facilities;

\$ 30 Subtotal

ON MAY 1, 1986

- \$ 1 • stop all overtime except to process tax returns;
- \$ 13 • defer all acquisitions of office equipment, supplies and services;
- \$ 4 • freeze hiring in direct revenue-producing programs (examination, collection) and in taxpayer service;
- \$ 8 • further reduce ADP equipment acquisitions;
- \$ 21 • cut remaining travel and training by 50%;
- \$ 23 • release 6,000 temporary employees in examination, collection and taxpayer service. About \$450 million in notice yield would slip from FY 1986 into FY 1987. Eight million taxpayer questions go unanswered.

\$ 70 Subtotal

- 5 -

(Amounts in Millions)

AMOUNT
SAVED

ACTION

ON JULY 1, 1986

\$ 30	● freeze permanent hiring, stop overtime and release 12,000 temporary employees in service centers (<u>severely cripple document matching</u> by eliminating TY 1985 paper, delaying TY 1984 underreporter notices, and stopping work on TY 1983 statutory notices);
\$ 41	● cancel all remaining ADP acquisitions (Automated Examination, Integrated Collection System, etc.);
\$ 7	● cancel all remaining travel and training.
\$ 78	Subtotal

ON AUGUST 1, 1986

--	● Use temporary accounting adjustments and transfer authority to delay furlough to the extent possible.
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IN SEPTEMBER, 1986

\$ 64	● furlough 18,000 permanent employees in IRS service centers on September 11 (deposit functions would continue; sharp rise in adjustments/correspondence inventories; major staffing impact in FY 1987);
\$ 45	● furlough 24,500 permanent employees in tax fraud, collection and taxpayer service on September 12. <u>About \$1 billion in notice yield would slip from FY 1986 into FY 1987)</u>
\$ 50	● furlough 32,000 permanent employees in examination, appeals and tax litigation on September 15;
\$ 3	● furlough 2,300 permanent employees in executive direction and policy and management on September 17.
\$162	Subtotal

\$340	Total, all actions.
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Prepared by: PM:PFR:F
April 21, 1986

Chairman PICKLE. Mr. Owens, would you mind identifying the gentlemen at the table with you?

Mr. OWENS. To my left is Mr. Ed Heironimus, who is Associate Commissioner of Data Processing.

To my right is Mr. Steve Taylor, our Finance Division Director.

Chairman PICKLE. Thank you, Mr. Owens, for your testimony and for the figures you have given the committee.

I think the first question I would want to pursue with you pertains to the supplemental bill that has passed the House last week. A year ago we had asked the Internal Revenue Service what positions you needed, what staffing requirements should be met and the Internal Revenue Service in effect stonewalled the request and said we are going to take a cut and we didn't need them. Now, you have not only needed them, you have said that there is a necessity and you have actually hired these people. The supplemental bill last week had \$340 million for the Internal Revenue Service.

You go into some detail, almost pains, to explain to us that if this supplemental isn't approved, the Internal Revenue Service will have to lay off some 6,000 employees in examination, collection and taxpayer services. Now, that is a week off. We find ourselves now a year later under the gun of 1 week's time, 10 days time, or less, and the supplemental has passed the House and hasn't passed the Senate. There are some questions whether the President will sign it or not.

Can you shed any light on the question of whether this appropriation bill containing the \$340 million that you so desperately need will be signed?

Mr. OWENS. Mr. Chairman, I fully hope that in the end the supplemental is passed and it is in a form that the administration can accept. It is my understanding, from what I have read in the newspapers at least, that the reports are that it is probably not acceptable as it stands now to the administration. However—

Chairman PICKLE. I did not say—you ran that a little bit fast.

Mr. OWENS. I would certainly hope that in the end the supplemental is passed and the \$340 million is also included by the Senate, and it is in a form that is acceptable to the administration. I can't project what might come out of the whole process and whether or not the bill that comes out of the Senate, and probably conference, will be acceptable to the administration.

Chairman PICKLE. Suppose the President vetoed the supplemental?

Mr. OWENS. Well, if in fact the \$340 million is not coming soon, we will have to take not only the actions we have outlined here, but additional actions. These were not new for the public record. We have stated these any number of times. There were letters sent to the leadership on both sides, the House and the Senate, by the administration outlining the necessity to have—

Chairman PICKLE. Mr. Owens, now, before you paint yourself within a white robe here, let me just interrupt you to say that while you have sent letters saying you need money, you are a year late in making the request for the funds, so I don't think the Congress is going to accept the fact that you have delayed in making these appropriations. We asked that question over a year ago, but that is a matter of fact, and the public will have to determine that.

My question is, apparently you feel that the President may veto the appropriation, the supplemental, or even if there is any delay in the Senate within a week or 10 days time, you are going to lay off 6,000 people. Is that correct?

Mr. OWENS. Mr. Chairman, I don't want to speak for the President on whether he will or will not veto the bill, and I don't want to project what the outcome may be. My hope is, that it is in a form in which that supplemental will be included that will be acceptable and——

Chairman PICKLE. I know you hope that. You are also faced with facts.

Mr. OWENS. That is correct.

Chairman PICKLE. And not hope, and it appears to me that if there are going to be some delays in the thing we have prospects of laying off 6,000 employees in areas that are desperately needed, particularly since they have been employed to try to make up for the horrendous year we had in 1985 in processing these returns.

Now, let me get back to the budget. I will try to save my questions until later so the members can have a chance to ask you questions.

When you started off you said a request to the Treasury for 98,000 staff positions had been made, and you said you needed 3,000 more positions. That was your request. Now, you come in with 3,000 less positions. What happened from the request you made to the time the Office of Management and Budget finally gave its approval and sent it up here? It seems to me you said we need these people yet they have been lost. What happened?

Mr. OWENS. Well, Mr. Chairman, through the budget process there are always discussions and negotiations that go on, and decisions are made by the administration based on the economic situation and overall policy that affect all the budget. The Internal Revenue Service is no exception to that.

Chairman PICKLE. I think we all recognize this fact. You start off with what you think are your needs. Then it goes to the Treasury—and in your case to the Office of Management and Budget—and that figure is usually cut back. So in this particular case you end up with 3,000 less positions at a time when we need them desperately, and yet you want to get by with 3,000 less. What bothers me is in two or three areas—I am going to mention them because I am sure the other members will be talking about the same thing—we received your figures, we have looked them over, but it looks to me like that you do say that you received some increases in certain positions, here are some of the areas of concern we have:

Your returns processing is cut by 1,590 staff positions and computer service is cut by 27 staff positions. Now, it seems to me that this is an unacceptable recommendation. You assume that your inventory for the service centers will be manageable. The information we have is that the Internal Revenue Service indicates that inventories will continue to be unacceptably high and staffing cuts just are not justified.

The second area of main concern is that the collection staff is increased only by 12 positions. It seems to me this is also bad. This is 1,000 less than the Internal Revenue Service had in 1985.

And third, taxpayer services show cuts in the number of taxpayers assisted. Fiscal year 1986 taxpayers covered will be 4.5 million less than in 1985. Now, it appears to me that where you have made some requests for your budget for 1987, and you show that this is an increase over the 1986 figures, still in many instances it is far less than what the 1985 budget had requested. This means that we are having to process over 2 million more returns a year. Now, in other words, 2 or 3 or 4 years later there will be 4 million more taxpayers submitting returns than are coming in now, yet you are requesting figures less than what we had before. Can you explain the overall discrepancies in those kinds of figures?

Mr. OWENS. Mr. Chairman, I agree with the figures you cite in terms of what our budget sets out. The 1987 budget was put together about 2 years ago and at that time, we made certain projections as to what our needs would be for 1987. At that time, we certainly didn't anticipate that things that would occur in 1985 and even later on throughout 1985. We had hoped to be a little further along than we are in some of the inventories.

Second, we are currently reviewing our schedules and work plans for 1987 processing of tax returns and the filing period as far as telephones are concerned. In looking at those, we have to take into consideration the situation right now, and while I don't want to go back and belabor the point on the 1986 supplemental, the delay in that. To the extent of our laying off the 6,000 employees and deferring some of the work which we have or will do or have done already, it will impact the fiscal year 1987.

So we are reviewing all of that now, and we will make some decision to see how the resources we requested in 1987 will in fact fit the 1987 needs.

I might add overall, Mr. Chairman, that the budget is significantly different from budget requests the Service has had before Congress in the past. For example, there is an 8,300 staff-year increase over the continuing resolution for 1986. There is some \$455 million in that budget over the continuing resolution for 1986. That is about a 12-percent increase in dollars and about a 9- or 10-percent increase in staff years.

Now, while faced with what we are looking at in 1987, you may question that; but I must tell you that if you compare that to prior years, we have averaged about a 1-percent increase in staff or 1.2- or 1.3-percent increase in staff each year for the last 10 years. In this budget, it is almost a 9-percent increase.

Chairman PICKLE. Mr. Owens, the net of it is your 1987 budget in most instances, many instances, is considerably less than what your 1985 budget was. That seems to be a fact. I don't think you can argue that. Do you deny that statement?

Mr. OWENS. No, I do not. There are some categories in which it is less, that is correct.

Chairman PICKLE. In most categories—two or three out of four, it seems to me. I think we have to be honest and say yes, that is a fact and instead of trailing off into these generalizations.

It is hard for me to understand how you can operate with efficiency with such crashes on an automatic budget level much less than it was 2 years ago. That is hard for me to understand.

Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman.

Mr. Owens, what is the best way to judge the efficiency of the Service, by ratio of employees to dollars or employees to tax returns? Is there a good way?

Mr. OWENS. Well, Mr. Schulze, I am not sure there is a very clear and precise way to do that. There are a number of factors that have to be taken into consideration in terms of the efficiency of the Service and I think when it gets down to the real efficiency of the Service, it is judged by the American people in terms of whether they perceive the Internal Revenue Service to be fair and effective and efficient in responding to their needs.

Mr. SCHULZE. It is true there has to be some kind of yardstick. Do you use a yardstick within the Service to judge efficiency? Should we devise one?

Mr. OWENS. We have a number of yardsticks to judge efficiency and they are different in different categories. We look at the number of returns, and we have various productivity rates. That is one of the problems that we ran into in prior years, where we pushed too hard to get rates too high, and that is one of the costs we are paying now in reducing those and utilizing more staff.

Mr. SCHULZE. Well, shouldn't we expect over the years an increase in the efficiency due to computerization, or is computerization only going to keep our head above water?

Mr. OWENS. We should, you are exactly right, we should expect efficiency. I think the Service has a record of providing efficiency and giving up resources, the automated collection system was one of those areas where we, in effect, paid for it by giving up the additional staff—some 1,700 positions.

Mr. SCHULZE. With what we anticipate is coming, in tax reform, can we also anticipate an increase in the efficiency per return? It seems to me, no matter where we end up with tax reform, we are going to be processing either fewer returns, or the process is going to be easier, automatic.

Mr. OWENS. I agree with that. I believe that is correct, and under the Senate bill I think there would be 6 or 7 million taxpayers who would probably come off the rolls and certain tax returns which will be less complicated. There will be fewer schedules to attach, less data to be included on the return, less data for us to transcribe, and fewer mistakes to be made. Overall, we will be in a better position to handle that after all the transition rules have taken place.

Chairman PICKLE. Are you making your budget estimates on the assumption that the tax reform bill will have passed?

Mr. OWENS. No sir, absolutely not.

Chairman PICKLE. It seems to me that is what you are indicating.

Mr. SCHULZE. That was not the thrust of my question. I am talking about the long range. I might add, Mr. Chairman, with the momentum of the tax bill, I think we are going to get something, and it looks like it will lead to greater efficiency and fewer people on the tax roles.

How are the decisions made for staffing cuts in the proposed reductions?

Mr. OWENS. Well, they are made in a combination of ways, depending upon the amount of the cuts. They were made in the past

by the Commissioner and me and other senior officials reviewing the total Internal Revenue Service budget. We look at total compliance, trying to keep a balance throughout the enforcement areas, recognizing sometimes that gets a little out of balance, but the intent is to have an overall balance within the compliance functions. But first and foremost, the resources have to go to receive the returns and process the returns timely, and issue the refund timely. Then and only then can the returns be made available for all the enforcement actions.

Mr. SCHULZE. So that it is a top level decision as to where the cuts are made?

Mr. OWENS. That is correct.

Mr. SCHULZE. How many of the 6,000 employees which will be separated if the supplemental does not go through, are temporary employees who ordinarily would be separated about this time?

Mr. OWENS. I believe all of those 6,000, Mr. Schulze, are temporary employees. We refer to them as WAE's [when actually employed]. They are brought on board, then they are terminated when the work is no longer there for them.

The work for those 6,000 is still there. We are and have been routinely terminating or furloughing some employees at this time of the year when the work is done. For example, in receipt and control, in the mail opening, we no longer have large volumes and so those people are normally furloughed.

Mr. SCHULZE. Of the four categories of—

Mr. OWENS. Excuse me, Mr. Schulze, let me make one other point. The 6,000 that we have been talking about are not in the processing area of the service centers.

Mr. SCHULZE. The four appropriations accounts on salary and expenses, am I correct that there are a total of 2,044 employees in this, and these are the four areas in which your budget is broken down? Is that correct, for personnel purposes?

Mr. OWENS. That is correct, we have four appropriations.

Mr. SCHULZE. And salaries and expenses 2,044?

Mr. OWENS. Yes.

Mr. SCHULZE. And processing tax returns, 27,327?

Mr. OWENS. That is correct.

Mr. SCHULZE. And examinations and appeals, 38,974?

Mr. OWENS. That is correct.

Mr. SCHULZE. And investigations, collections and services, 26,739?

I presume you do not have but will you provide for me the figures on the number of employees in these four areas over the last 10 years and also your projections for the next 3 or 4 years under normal circumstances?

Mr. TAYLOR. Yes.

Mr. OWENS. I will be happy to provide that. I do not have those figures with me broken down in those categories. I have them in some specific categories but not in that category.

Chairman PICKLE. Mr. Dorgan.

Mr. DORGAN. Thank you, Mr. Chairman.

Mr. OWENS. I have come to feel that the Internal Revenue Service has some good people working for it. I don't mean to sound as if you don't understand that. But I feel, having sat on this committee over the years, we have been misled. I feel somehow that the

people downtown who have worn rose colored glasses on most subjects are saying we will do this and it will work out and nobody has to worry about it, have convinced some people at Internal Revenue Service to accept that and not say anything.

What I watched over the last few years, particularly, but in some areas a longer period than that, is a substantial erosion in the ability to enforce the Tax Code. We now see that in 1986 we have \$45 billion in money that is owed in accounts receivable, yet there is a proposed decrease in staffing for accounts receivable. We have tax compliance problems to the tune of about 18 or 19 percent. That is \$100 billion in lost revenue a year that is not reported and not collected.

Now, Mr. Schulze raised the question, and appropriately enough, how much money should we allocate to our tax collecting function? We have about \$995, almost a trillion dollars, in the current budget, and your portion of that is slightly less than one-half of 1 percent. The question Mr. Schulze asked is one that we ought to answer, the one you ought to help us answer, with some real courage, without worrying about who is going to say what.

What is necessary to be allocated here in the revenue function to do the job that you and I think we ought to do?

I do want to ask some questions in line with the questions Mr. Pickle asked because, again, I think we are being misled, or have been misled with respect to what we really ought to be doing and what the professionals who know about our revenue base feel we ought to be doing.

I have not seen any big flag going up or bells going off down at Internal Revenue Service in recent years saying, wait a second, if you do this it is going to result in a substantial decrease in compliance in our revenue system. I have not heard anybody say or give us that kind of warning, yet we are not experts up here, we are trying to rely on your experience and your ability.

Let me ask you some questions, if I might. The Internal Revenue Service has had a 38-percent increase in tax returns filed since the midseventies, about a 10-year period. In that period, you have increased your personnel by 9 percent. That increase is not very significant. To me it doesn't say much because I don't know where those 9 percent went. But in some critical areas, such as revenue agents and auditors—revenue agents, the folks that go out and actually work with the books and records of the taxpayer who have a questionable return, or for whom we have reason to think there might be some questions about the return, and auditors who do the office auditing function down at Internal Revenue Service—personnel has decreased. From 1980 to 1985, which are the years that I have numbers for, in terms of actual levels of personnel, in both instances we have had decreases in employment levels from 13,800 to 13,500 in revenue agents; 4,600 to 3,000 in tax auditors.

Now, we are going to increase those a bit in 1986 and 1987, but my question is, at a time when we see this incredible erosion of our ability to enforce the laws, why do we not see dramatic alarms being sent up by Internal Revenue Service about decreases in staffing levels?

Mr. OWENS. Well, Mr. Dorgan, we have discussed that any number of times, and I certainly don't want to leave any ideas here

with any member of the committee that we have misled them. If that has occurred, I apologize for that.

The examination of tax returns, I think, has to be looked at in several different areas. One is—I would agree, I think most people would agree—that the level of the examinations that we now have is too low. Audit coverage is now about 1.2 percent, projected to be 1.4 percent for next year. I don't think that is an issue with most people. I think the issue comes as to how high it should be. Certainly it can be raised before we get into any danger of that.

Another point I think we must look at is what has occurred over the last several years. This is by no means trying to apologize for the figures, but trying to put them in some perspective.

You also have to look at the no-change rate, that is, the number of returns that we do not change after an examination, because there is no additional tax or refund due from the taxpayer. To the extent those were counted in the past, there are fewer of them now. The no-change rate we refer to has consistently decreased over the last 5 or 6 or 8 years. Therefore, the returns that we are examining are the more appropriate ones, where the potential for revenue is. So that is one factor that must be looked at when we look at overall staffing and revenue agents. But with the increase in returns and that is where the category—

Mr. DORGAN. Let me try to understand that. Explain to me again about your no changes. Evidence abounds that cheating is increasing on tax returns in this country, and it seems to me that that represents all sorts of opportunities for lucrative tax audits that we ought to be conducting. You are talking about dramatic increase in no-change audits?

Mr. OWENS. Yes.

Mr. DORGAN. Could you explain the inconsistency there?

Mr. OWENS. I don't think there is any inconsistency. I think it is a different understanding of it.

The no-change rate is one indicator of the efficiency of the use of those resources. For example, if you examine 100 returns and on 50 of those returns there is a no-change, that means there is no revenue due the Government and no refund due the taxpayer. If you turn that around and you examine 100 returns with the same resources, and on 80 or 85 of those returns there is some additional tax due the Federal Government, and on only 14 or 15 there is no tax due, then I think there is a tremendous difference in the overall effect and efficiency. We have a better selection process now than we had 5, 8, or 10 years ago.

Mr. DORGAN. Despite that, we still have an increasing amount of revenue that is uncollected?

Mr. OWENS. Yes, sir.

Mr. DORGAN. It seems to be at odds with the assertion that we have a more improved enforcement ability through our examination procedures. You are not contending that. Let me ask a question in the area of tax fraud. We have an area down in Internal Revenue Service called tax fraud investigations. Again, from all of the evidence that exists in this country, particularly a lot of polling and other empirical evidence, in addition to polling, tax fraud is on the increase. You are at the point of proposing a decrease in the

number of positions dealing with tax fraud in your tax fraud investigations section. Are you comfortable with that?

Mr. OWENS. Well, I am certainly not comfortable with the tax fraud that you refer to and that we know is there. I think that area of the budget is different from others in terms of the overall resources. It has remained basically flat in terms of staffing over the last 8 or 10 years.

Mr. DORGAN. It seems to me that you have a revenue base in which you collect only 1981 percent of the base and the other 19 percent is not even reported. That is not accounts receivable, it is unreportable. That represents an evasion, avoidance, and fraud in most instances. If you face those kinds of compliance and enforcement problems, wouldn't you want to beef up those areas rather than decrease them? The question is, are you comfortable with the proposed decrease?

Mr. OWENS. Well, the answer is that in all of our enforcement areas, they will return on average taken totally, about \$10 for every dollar we put into them. So I am uncomfortable to know that the revenue is not being collected as it should be collected, not only in the criminal area, but in other unreported income and failure-to-file-return areas. The \$45 billion we referred to.

Mr. DORGAN. I guess what I am getting to is the symbolics of our problem in determining how much we spend on tax enforcement in the area of tax fraud investigations and in the area of enforcement litigation and rulings, which is also a supplement to that.

Mr. OWENS. That is correct.

Mr. DORGAN. In the case of tax fraud investigation, we see proposed decreases at the point in staffing levels. It seems to me if this were our business, if it were Mr. Schulze and my business—both of us have owned businesses—we have a revenue side to the business in which we had people sitting at a desk whose job it is to bring in the money. If we had this situation existing with the increasing tax gap, 19 percent, and increases in accounts receivable going from \$30 billion to \$45 billion in a very short time, we would have all sorts of bells going off. We would say by God we are going to do something. My guess is we wouldn't say what we are going to do is to cut tax fraud staffing or cut enforcement litigation staffing and we are not going to beef up revenue agents and tax auditors. We would appropriate funds to attain some goal that would get us back toward some reasonable level of enforcement.

The point I am making is that I think you have a responsibility to tell us, without representing what Treasury or Office of Management and Budget is saying, what we should do. I don't hear that, frankly. I hear very carefully stated caution, respectful reports, but I am wondering what the hell should we be doing about a massive national problem here that loses, if we had some marginal better collection, probably \$40-\$60 billion or \$100 billion. That evaporates every year.

Mr. OWENS. I certainly don't agree with the analogy you draw between the business you and Mr. Schulze might have had. From the tax administrator's standpoint, I would agree there are resources needed in these areas. As I indicated earlier, there are other decisions that are made, and other issues that are taken into consideration that may be unrelated to what a tax administrator

might think when a final analysis is put together and sent to Congress.

Mr. DORGAN. Who is making them and with what information? The information we need from you is information that will demonstrate the folly of those other decisions. We have the opportunity with marginally better enforcement to collect \$30, \$40 billion additional revenue a year. That is getting freeloaders to start paying taxes again. That is what that investment ought to represent.

Mr. OWENS. We certainly can provide to you the information we have. I don't have all the information that goes into making the overall budget. We can provide you detailed information relating to the requests and the staffing of the Revenue Service and how they were put together.

[The information follows:]

INTERNAL REVENUE SERVICE
STAFFING BY APPROPRIATION

Account	Salaries and Expenses	Processing Tax Returns	Examination and Appeals	Investigation, Collection and Taxpayer Service	Total
Fiscal Year					
1978 Actual	4,455	33,504	29,377	17,993	85,329
1979 Actual	4,534	33,865	29,375	29,375	97,149
1980 Actual	4,551	34,335	30,254	18,324	87,464
1981 Actual	4,523	32,806	29,260	19,567	86,156
1982 Actual	3,952	28,007	29,416	21,482	82,857
1983 Actual	2,135	20,533	32,720	28,215	83,603
1984 Actual	2,284	21,743	33,981	29,621	87,629
1985 Actual	2,271	26,075	35,089	28,824	92,259
1986 Request	2,071	28,944	35,923	35,923	102,861
1987 Request	2,044	27,327	38,974	26,739	95,084
1988 Projected	2,086	27,765	41,983	27,373	99,207
1989 Projected	2,086	28,215	44,877	27,373	102,551
1990 Projected	2,086	28,665	45,323	27,373	103,447
1991 Projected	2,086	29,115	45,510	27,373	104,084

Chairman PICKLE. Mr. Guarini.

Mr. GUARINI. From the questioning Mr. Schulze asked you, apparently there are wide swings in collection strategy and shifting of personnel. You are running probably the biggest business in the world, collecting some \$500 billion or more a year. I don't seem to glean that there is any consistent strategy for effective use of personnel and that this varies from time to time. There doesn't seem to be a sound business principle.

If I were running a business, I would have a feasibility study as to how I would maximize my business operations, and I would have bell curves where at a certain place it is wise to have personnel and past a certain point I get on the down side, and I could maximize—make modules and charts and know where I am going.

Running a big business like you are at IRS, do you have this knowledge as to where you can maximize your personnel and how

you can maximize your collections and present to Congress a plan or a strategy for IRS?

Mr. OWENS. We have most of the information you outlined. We have a computerized model for enforcement resource allocations that we have been working on for about 3 years so that we would have marginal yield data available for our major enforcement programs. I would like to say to you that that is complete. It's final phase, the yield optimization section will be operational this summer.

Mr. GUARINI. We have been running an Internal Revenue Code since 1913, I believe. You mean to tell me now we are about to have one? Isn't this long overdue? Don't you think the American public deserves, if it is going to put its confidence in the IRS, a program where all Americans can be treated fairly, that they can have that confidence?

Mr. OWENS. We have, and have had in some of those areas since 1975, a model that will do what you just said. In examination, we have the most advanced model. We have not had that sophistication in collection and some of those other areas until now. The model, to be completed this summer, will use marginal yield analysis to maximize yields.

Mr. GUARINI. I don't understand why you don't put sound business principles at work in the IRS. If you were running a steel plant, an automobile plant, any kind of business operation, it would be so. Why can't Government do that?

Mr. OWENS. I think Government can do that and we have done that. I think we have moved a long way. I can't go back and talk about the 1920's and what was and what was not happening. I know in recent years we have spent a great deal of time and money in developing computerized resource allocation models. It is a very, very complex problem, and we have had a number of people come in from the outside and look at it and kind of shake their heads and walk away. In fact, it is not something they want to tackle.

Mr. GUARINI. Do you get independent authoritative advice?

Mr. OWENS. Yes, we do. Contractors outside the Revenue Service provide it.

Mr. GUARINI. Is the underground economy increasing in this country today?

Mr. OWENS. I think if you look at the dollars, the dollars are certainly increasing. I believe in the latest figure we have, the rate of noncompliance has slightly decreased. I can't tell you why except there has been a lot of legislation. Maybe that is part of it.

Mr. GUARINI. So the dollars are increasing?

Mr. OWENS. Dollars are increasing.

Mr. GUARINI. Is compliance worsening in our country today?

Mr. OWENS. It may not be and the figures we have do not show that gap is getting wider.

Mr. GUARINI. We are getting better in compliance, the public feels the present Tax Code is fair and equitable and more are complying than they had in previous years? Is that what your testimony is?

Mr. OWENS. No, it is not. The testimony is that the figures that we have show there has been a slight increase in the rate of compliance as a percent of the total.

Mr. GUARINI. If that is so, perhaps we don't need a new tax reform code. I understand it was getting worse over the past several years.

Mr. OWENS. In dollars it is getting worse. It is significantly higher than——

Mr. DORGAN. Isn't it a fact that in percentage terms it is getting worse? I think the Internal Revenue Service's own estimate is 81 point something. This is a recent estimate.

Mr. GUARINI. A drop from 1984.

Mr. DORGAN. Isn't that a deterioration over the last 4 or 5 years? Haven't we seen a continual deterioration? We are talking about the so-called tax gap.

Mr. OWENS. In the tax gap, I am informed that, in fact, our TCMP data shows there has been an increase, a very slight increase, in compliance.

Mr. GUARINI. In the number of returns that are filed?

Mr. OWENS. No, we have no indication of improvement in compliance with the filing requirements. The new data I am talking about deal with the accuracy of the tax reported on individual returns which are voluntarily filed.

Mr. GUARINI. Is that so in the last 5 years? Because I understood compliance fell from 1984 to 81 percent. That gave impetus to have tax reform. The Republicans feel it was simple or it was fair enough——

Mr. OWENS. All I am saying is the last figure that we have, which is our Taxpayer Compliance Measurement Program figure, where we have the statistics and make the projection, it shows compliance rose very slightly for the last year. I think that was the 1982 tax year.

Mr. GUARINI. Would you be good enough to supply for the record statistics for the last 5 years as to the tax compliance from various different angles?

Mr. OWENS. We would be happy to do that.

[The information follows:]

IRS ESTIMATES OF INCOME TAX COMPLIANCE

IRS' most complete measures of income tax compliance--and noncompliance--come from its tax gap research. For a given tax year, the tax gap is the amount of income tax owed for that year but not voluntarily paid. The compliance rate is the income tax voluntarily paid as a percentage of the total amount owed for the year in question. IRS estimates and projections of the income tax gap and associated compliance rate are shown in Table 1.

Table 1. Income Tax Gaps and Compliance Rates

Year	Tax Gap (\$ billions)	Compliance Rate (percent)
1973	29	84.0
1976	39	83.3
1979	62	82.1
1981	82	80.7
1982	84	80.3
1983	79	80.9
1984	84	81.3
1985	92	81.6
1986	103	81.5

The estimates in Table 1 include all legal-sector income taxes--corporate and individual. The tax gaps include non-filers and filers of tax returns. They include the non-reporting of taxes due and also the non-payment of taxes voluntarily reported as due. And, they include estimates of the tax due on unreported income, whether or not that unreported income can be detected in audits of the recipient taxpayers' tax returns. This last is a very important distinction when contrasting these estimates of compliance with the "voluntary compliance levels" discussed next.

Under the Taxpayer Compliance Measurement Program (TCMP), the Internal Revenue Service conducts a variety of large-scale compliance studies. For TCMP income tax studies, representative samples of filed tax returns are thoroughly audited. Data from the audits can be used to estimate the amount of additional income tax and penalty which would be assessed if all tax returns were audited. Income tax TCMP studies are done periodically for individuals and small corporations (less than \$10 million in assets). The data are used in the tax gap research program and for other purposes. The results of each study are summarized in a statistic called "Voluntary Compliance Level" (VCL). For the population of individuals or small corporations who file tax returns, this statistic expresses the amount of tax voluntarily

reported as a percentage of the total tax and penalty which was voluntarily reported or would be assessed if all returns were audited. The VCLs for all of the completed TCMP studies of individual income tax returns are shown in Table 2.

Table 2. Taxpayer Compliance Measurement Program Estimates of Voluntary Compliance Level--Individual Income Tax

Year	Voluntary Compliance Level (Percent)
1965	94.3
1969	93.1
1973	93.0
1976	91.7
1979	91.0
1982	91.8

VCLs are generally higher than tax gap compliance rates because some kinds of noncompliance are not included in the calculation of VCLs. The following are the major differences.

- The tax gap compliance rates include the unreported income tax liabilities of non-filers; VCLs deal only with filers.
- The tax gap compliance rates account for taxes which are voluntarily reported but not voluntarily paid; VCLs deal only with the reporting of tax liabilities and do not account for the non-payment of tax.
- The tax gap compliance rates are based on estimates of total unreported income; the VCLs cover only unreported income which can be detected in a thorough audit.
- The tax gap compliance rates cover corporate income tax as well as individual income tax.

Mr. GUARINI. Is the morale, with the Gramm-Rudman tax cuts, of the IRS up? Are you losing trained personnel as a result of people being disappointed and maybe not getting their increases in pay or fearing they are going to be laid off? What impact does Gramm-Rudman have on the morale of the IRS?

Mr. OWENS. I am not sure how much is directly related to Gramm-Rudman.

Mr. GUARINI. The effectiveness of your being able to collect taxes.

Mr. OWENS. I hesitate to categorize it with one or two words. I think there is a great deal of concern overall, and there is more concern in different classes or different groups of the work force. For example, those hired after January 1, 1984, currently receive a reduction in their take-home pay because they are required to make contributions to Social Security, as well as civil service retirement, until such time as that issue has been resolved. So if you look at their pay checks, there is about a 35 or 45 percent cut before they ever get it.

Mr. GUARINI. Are you losing personnel as a result of this?

Mr. OWENS. I am told by our field people those people are looking for jobs. We have lost some. I don't have any number for you. But there are a number of things that concern the work force, and Gramm-Rudman is one of those things. They are concerned about it, and certainly that is one of the reasons we have been doing everything we can to delay any reductions or cutbacks because of the 1986 supplemental, the shortfall—

Mr. GUARINI. Have you been spending money up front hoping you are going to get a supplemental later in the year? Have you been disproportionately spending the money you have been allocated?

Mr. OWENS. Yes, we have. We have been spending the \$340 million as if it will be appropriated.

Mr. GUARINI. You will be in a disaster if you don't get your supplemental.

Mr. OWENS. That is correct.

Mr. GUARINI. If you spent your money in the front part of the year.

Mr. OWENS. That is correct.

Mr. GUARINI. Have you gotten this message to the White House?

Mr. OWENS. Yes, we have, and there has been some correspondence on it. I understand there will probably be more this week. There was a notification of deficiency that came up to the Congress. It was for only \$273 million, but they strongly urged urgent treatment, and, in fact, if it were legally possible, they would have asked for the full \$340 million.

Mr. GUARINI. Let me just lastly—

Chairman PICKLE. Let me ask on that point. Why did not the administration request these funds a year ago or 6 months ago?

Mr. OWENS. Well, the request was sent up in early February, Mr. Chairman, as part of the President's budget.

Chairman PICKLE. During 1985, why did you not make some request for additional funds instead of asking for a cut?

Mr. OWENS. Mr. Chairman, I can't answer why the supplemental didn't get here until early February. We developed it some time

ago and were negotiating and working our way through the system.

Chairman PICKLE. I think, Mr. Owens, we all recognize the answer to that lies basically in the fact the administration simply didn't want to make any request for additional funds for the Internal Revenue Service, or if they had, they would have felt that would have opened it up for a dozen other agencies, and, therefore, the whole budget process would be gone.

So in the process of just being consistent, the Internal Revenue Service finds itself in a great crisis and the American people are going to be hurt because of it. That I think is a fact, and I think we ought to admit it. What we are trying to say is can we prevent that kind of thing as we go along? This committee doesn't take pleasure in recommending we ask the Appropriations Committee for additional funds or additional personnel, which we have done in writing, contrary to what the administration has asked. We are trying to force you to do the responsible thing, and you wouldn't do it last year.

That is the problem we are going to face in any administration unless we determine that the Internal Revenue Service is going to be a first-rate quality organization. Until we make that kind of commitment, it seems to me we are going to have these same kinds of hearings year after year after year.

Excuse me, Mr. Guarini.

Mr. GUARINI. Let me ask, the public is very concerned about how you operate. Have you found your correspondence inventories are getting increasingly more behind and it takes you longer to answer your mail and your letters and your inquiries?

Mr. OWENS. Overall, I would say we are not where we want to be, certainly, in answering the correspondence.

Mr. GUARINI. Is it worse? Is your correspondence inventory reaching greater crisis?

Mr. OWENS. In some categories, it has increased. It is an area that concerns me and has concerned us for quite some time. We had projected we would have a lower inventory right now of correspondence. We simply have not been able to get it down, though.

Mr. GUARINI. Don't you have to send notices out and answer the letters later because you are so far behind, you almost have to send two letters instead of one, which only gets you further behind?

Mr. OWENS. That sometimes has tended to be the case, because we go in a circle on it.

Mr. GUARINI. Isn't it true the phone requests that are coming in are worsening every year, that the public is getting less service by the telephone than they have in previous years?

Mr. OWENS. Not in 1986.

Mr. GUARINI. We have had a number of hearings and inquiries about this in the past, and we understand that the public has been grossly disappointed as to the response by IRS on the phone.

Mr. DORGAN. Would you yield on that?

Mr. GUARINI. Certainly.

Mr. DORGAN. Last year there were about 100 million calls unanswered, and during the processing season, 9 out of 10 got busy signals. We don't have any information on 1986, and I would appreciate if you could provide the committee some. I know additional

people were allocated to that function, as well as additional phone lines. The fact is, the Internal Revenue Service has centralized it and said "We will still serve you, all you have to do is pick up the phone."

At least in some instances, those who live in the less sparsely populated areas of the country find great difficulty in getting responses. I would appreciate any additional information you could provide for 1986.

Mr. OWENS. Surely, part of the supplemental is for additional staff, for telephones and so forth. So far in 1986, we have operated where about 80 percent of the people reached us, on the average, the first time they called. That is the first time in several years we have attained that objective.

[The following was subsequently received:]

LEVEL OF TELEPHONE SERVICE

During the 1986 filing period, we provided easier access to the toll-free telephone system than in 1985. Seven hundred additional telephone assistants (a 26 percent increase over 1985) were added and 336 additional lines (an 11 percent increase) were installed. Even though staffing and circuitry were increased to handle far more calls than in 1985, our excellent processing year contributed greatly to an actual reduction in the demand for telephone assistance.

Mr. GUARINI. I want to thank you, Mr. Owens. It seems to me the IRS demands efficiency and accurate recordkeeping from American individuals and the American people, and I think that is the least that the American people should expect from the IRS.

Thank you very much.

Mr. OWENS. I would agree, and I would agree that is directly related to compliance.

Chairman PICKLE. Mr. Owens, can you tell us the status of the backlog at the Internal Revenue Service now? Somewhere between April 1 and April 15, you received, I guess, some 40 to 50 million returns. I don't know what the number is, but it is a large number. And the true test of whether Internal Revenue is going to break down again this year may remain within the next 30 days.

I would like to know the status, as of now, as to the backlog of inventory with respect to error resolution, unpostables and accounts receivables—can you give us those figures?

Mr. OWENS. I believe I can, Mr. Chairman.

Chairman PICKLE. I have a chart here. Do you have that same attachment?

Mr. OWENS. I think I have the figures. As far as the 1985 tax returns are concerned, as I indicated earlier in my testimony, we have processed those at a record rate, and we do not have backlogs as it relates to those returns. They are on schedule, and the system is working extremely well in all the areas.

Chairman PICKLE. I have some information here, and we have it from the Service. I don't know how it stacks up with your figures. Let me show you what the chart we have shows. With respect to adjustment inventory, in 1984, you had 564,000 cases pending. On April 30, 1985, you had 820,000 and on April 18, 1986, you had a 1,128,000 inventory level. So that shows in 1986 you have over a 1.1-million inventory still to be handled in correspondence adjustment.

In the unpostable inventory area, it shows that in 1984, you had 987,000; on April 26 of last year you had 2 million; and on April 25 this year, you have 1,668,923. That is less than in 1985 but almost double the 1984 level.

And in the accounts receivable inventory, in 1984 you had 30 billion; in 1985, 43 billion and on March 31, 1985, 45 billion. Do your figures disagree with those?

Mr. OWENS. No, they do not.

Chairman PICKLE. Then it seems to me you have a big backlog. Are all the refunds taken care of this year? Are you current on refunds now?

Mr. OWENS. We are current on refunds in the 1985 returns, that is correct. We have the problems in those areas you identified. As you recall, Mr. Chairman, last year we had problems in all the inventory items.

Chairman PICKLE. When you say 1985, you mean the 1985 returns refundable in 1986?

Mr. OWENS. That is correct.

Mr. DORGAN. Will you yield on that?

Chairman PICKLE. Mr. Dorgan.

Mr. DORGAN. The refunds must be processed before June 1 lest you have to pay interest. Are you saying that you will have those refunds out by June 1?

Mr. OWENS. No, I am not saying that. We always have some refunds on which we pay interest, for a variety of reasons. Returns are being processed on a timely basis, but more returns are being filed later in the filing period, and as a result of that, you are getting a bigger and bigger crunch on April 15. We will pay interest this year, but it will be substantially less than the interest we paid in 1985.

Mr. DORGAN. Do you have any estimate on that? I think we appropriated around \$40 million for that purpose.

Mr. OWENS. We project somewhere around 20 to 25 percent less interest in total, which would be about \$33 million.

Chairman PICKLE. Mr. Owens, I want you to submit for the committee a factual statement that pertains to the addendum you submitted in your testimony to us with respect to how the Internal Revenue would distribute additional staff and funding. That is in your statement. That is, I want to know, how would you spend additional funding, in taxpayer service, computer modernization, enforcement or to deal with receivables and tax shelters.

Now you make a general statement, but you don't give me a breakdown in various categories. I want you to submit that for our consideration.

Mr. OWENS. We will be glad to do that, Mr. Chairman.

[The information follows:]

INTERNAL REVENUE SERVICE
ALLOCATION OF ADDITIONAL RESOURCES
FISCAL YEAR 1987

Chairman Pickle of the Subcommittee on Oversight, Committee on Ways and Means, asked IRS, on May 1, for information on how IRS would allocate additional resources, over the levels proposed in the FY 1987 budget which is now pending before the Congress.

Basic Responsibilities

The Internal Revenue Service has to meet certain basic responsibilities to the taxpaying public: to process tax returns accurately, issue refunds timely, properly credit and maintain tax accounts, and assist taxpayers in meeting their filing requirements and in resolving concerns on the status of their tax accounts. The Service is now reassessing the resource levels for tax processing and taxpayer service in light of current filing season experience and in consideration of projected workload and employee productivity next year. Depending upon the results of this reassessment, the Service may need additional resources for tax processing and taxpayer service. Any additional needs will then be considered by the Administration and the Congress.

Tax Enforcement and Revenue Collection

After ensuring that the Service's basic responsibilities are met, additional resources, if made available, would be allocated to revenue-producing functions.

In FY 1987, IRS will collect, after refunds, some \$800 billion, over 90% of all federal receipts. IRS operating costs (the FY 1987 budget) total \$4.1 billion, a yield to cost of almost 200 to 1. Included in total tax revenues is \$38 billion which results from direct enforcement of the tax law: examining tax returns, collecting unpaid taxes, securing delinquent returns, matching information documents. These programs produce, in the composite, ten dollars in tax revenue for each dollar spent. Although additional resources, if allocated, would produce somewhat less tax revenue (the marginal yield curve), the return on further investments in tax enforcement would still be substantial, ranging from 12 to 1 for collecting taxes owed but not paid to 4 to 1 for examining individual income taxes at IRS district offices. Including major acceleration of tax revenues by speeding up settlement and litigation, an allocation of 3,000 additional positions, at a cost of \$130 million, would produce \$1.2 billion in revenue collected next year, a return of 9 to 1.

Additional Funds (non-staff)

Additional funds, if made available, would be allocated for ADP and systems modernization: first, to maintain computer capacity for tax processing; second, to meet increased workload (sending bills and notices, distributing tax forms); and third, to improve tax enforcement (examination, collection, tax fraud).

INTERNAL REVENUE SERVICE
FY 1987
PROPOSED ALLOCATION OF ADDITIONAL FUNDING
(NON-STAFF)

AMOUNT
IN PRIORITY ORD
(MILLIONS)

ADP and Systems Modernization: Tax Processing

\$25

To maintain our tax processing system, additional ADP resources are needed to continue the replacement of our on-line data entry and retrieval system for answering taxpayer inquiries and transactions. In addition, ADP funds are needed to lease and maintain the system upgrades installed this year in the National Computer Center and the ten service centers. These needs surfaced after the FY 1987 budget was developed.

ADP and Systems Modernization: Service to the Taxpaying Public

\$25

To improve upon the quality of service, additional ADP resources are needed to keep pace with the increasing volume of bills and notices sent to taxpayers and to ensure that tax forms, instructions and publications are distributed to taxpayers in time for them to prepare and file their returns.

ADP and Systems Modernization: Tax Enforcement

\$25

To improve our tax enforcement efforts, additional ADP resources are needed to reduce inventories of taxes owed, but not paid; move further on automation of the examination process; and to begin automating our efforts to investigate tax fraud and combat crime and drug abuse.

Total

\$75

INTERNAL REVENUE SERVICE
FY 1987
PROPOSED ALLOCATION OF ADDITIONAL STAFFING: ENFORCEMENT

ACCOUNTS RECEIVABLE 500 positions and \$22.5 million

The Service would allocate additional resources to collect taxes owed but not paid and thus reduce delinquent accounts in active inventory. About \$270 million would be collected from this effort in FY 1987.

ACCOUNTS RECEIVABLE 500 positions and \$22.5 million

The Service would further allocate additional resources to collect unpaid taxes by closing delinquent tax accounts now in inventory and expand notice processing to speed up revenue collection. About \$225 million would be collected from this effort in FY 1987.

DETERMINING TAX LIABILITIES 500 positions and \$18 million

-- Appeals and Tax Litigation 200 positions and \$ 7.3 million

The Service would apply additional resources to settle and litigate over 3,000 cases, with primary emphasis on cases involving \$100,000 or more in potential tax liability. By closing these cases, the Service would accelerate collection of tax revenues by \$330 million in FY 1987.

-- Examination 300 positions and \$11 million

The Service would apply 100 positions to correspondence examinations conducted in the ten service centers involving issues such as unallowables, self-employment tax, and multi-filers. An additional \$23 million would be collected in FY 1987.

Another 200 positions would be applied to examining employment tax returns. These examinations would be conducted by revenue officers in connection with their work on securing delinquent returns. An additional \$48 million would be collected in FY 1987.

ACCOUNTS RECEIVABLE 500 positions and \$22.5 million

The Service would further apply additional resources to collect unpaid taxes by closing more delinquent accounts in inventory. An additional \$135 million will be collected in FY 1987.

DETERMINING TAX LIABILITIES 1000 positions and \$37 million

The Service would further allocate 600 positions to examining employment tax returns. An additional \$ 120 million will be collected in FY 1987.

Another 400 positions would be applied to examining individual tax returns in the district offices. An additional \$52 million will be collected from this effort in FY 1987.

Total, Enforcement	3000 positions and \$130.8 million, with revenue collected of \$1.2 billion, a yield to cost ratio of 9 to 1.
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Chairman PICKLE. I notice that you make your 1987 request for some additional personnel, which is much less than your 1985 level, and yet in both fiscal 1986 and in the 1987 estimate, there are 1,700 permanent positions that are not filled. In other words, you are asking for these people in total, but you don't spend the funds for them, you don't hire them because there are that many positions that haven't been filled. Is that just because of the normal process, or because you can't find qualified people? Are you just trying to save money? What is your analysis of the fact you desperately need these people and yet there are 1,700 of them that haven't been hired?

Mr. TAYLOR. Mr. Chairman, that represents only about 2 percent of our permanent employees. What it represents is the fact that when a vacancy comes up, we fill our positions competitively, and it takes some time to fill a position competitively. So it is a normal lapse in the time to fill the vacancies that occur, many of which can't be predicted.

Chairman PICKLE. Why aren't the permanent positions filled?

Mr. TAYLOR. When a vacancy occurs, it takes some time to fill it.

Chairman PICKLE. You don't fill a position except where there is a vacancy. Are these 1,700 people over and above your staff level now?

Mr. TAYLOR. No; that would represent an estimate of the number of permanent positions that would normally be vacant at a given time. I think that number represents the end of the fiscal year. In other words, throughout an organization of 95,000, you might have that many positions that don't happen to be filled on that day. The process of filling is taking place through competitive selection. So it is not unusual at all to have roughly a 2-percent vacancy rate in an organization our size.

Chairman PICKLE. On the surface, it appears to me even though you are asking for personnel and you need qualified people, you still have 1,700 positions, permanent staff, waiting to be filled if you would just go hire them. I am trying to find out is it because you can't find these people or you just don't intend to spend the money in the first place?

Mr. OWENS. We do intend to spend it. I think what Mr. Taylor is stating is that with 95,000 people, there are always people every week or every Friday that are leaving the Revenue Service, and when you start to recruit and fill those positions, in some areas we have had difficulty with that and there is a lapse of time. From the time you get those 1,500 to 1,700 on board there are another 1,500 or 1,700 that have left the Service.

Chairman PICKLE. You had a correspondence adjustment backlog of over a million, 1.1 million. Is that normal, is that customary? Are you satisfied with that?

Mr. OWENS. That is not normal, and I am not satisfied with that.

Chairman PICKLE. Unpostable inventory, you had a 1.6 million unposted inventory. Is that acceptable?

Mr. OWENS. No; that is not acceptable.

Chairman PICKLE. Accounts receivable, you are cutting the collection function at a time when that is the source of money. Is that acceptable?

Mr. OWENS. From the tax administration standpoint, we would need to have more resources devoted to that, that is correct.

Chairman PICKLE. The question we have to ask ourselves is, what are you doing about that?

We have other witnesses, and I don't want to go on—I want to start off, as I did at the beginning. You are in a critical situation now because of the pending supplemental. However, the fact of the matter is we have waited and waited until the third quarter to put on these additional personnel you knew you had to have a year ago, and no request was ever made for them.

Now the supplemental is caught up in the controversy of other issues, such as deferral, and who knows what will happen? They are both important issues. The fact of the matter is you have to have money, and you are not going to get it, so you are just serving notice to the public now you are going to have to lay off about 6,000 people in the next 30 or 60 days unless that supplemental funding is made available. I find that unnecessary.

And now you come in with a 1987 budget, and this is repetitious now, because this is the fourth hearing we have had on the budget. You come in with a request that looks good, and yet in three or four major categories there is less requested than what you had in 1985, for example, in returns processing, collection and taxpayer services.

I would hope at some point we can devise some kind of system whereby the Internal Revenue Service, which collects 90 percent of our money, can come in with a budget that is adequate and that you can be given the authority to actually hire the necessary personnel to make the Internal Revenue Service the ideal—the wonder of the world.

If our rate of compliance constantly goes down, as it has now to 80, 81 percent, although you said it has gone up imperceptibly, you haven't given me a figure, whatever it is, it is fuzzy, maybe it is a little increase, the fact of the matter is the rate of compliance is getting dangerously low.

It seems to me like this committee ought to be given testimony by the Service that says "We need the following because it is the very heart of the operation," and I hope that time will come.

Mr. Dorgan, do you have a question?

Mr. DORGAN. Mr. Chairman, I wanted to observe, based on what you were saying, you seem to want Mr. Owens to say something that he probably can't say. It is only Monday, the first day of the week, and he would have an awfully difficult week if he said today "The Treasury Secretary or OMB or the administration has made some foolish management decisions that all of us understand." You don't, when you have a \$45 billion accounts receivable that has been increasing, radically cut your funding for that function. I understand why you don't want to say what Mr. Pickle seems to be asking you.

Sam Irvin used to say there are two ways to draw a picture of a horse. One is to draw a picture of a horse. The second way is to draw a picture of a horse and underneath write "a horse." You have drawn a picture of a horse with your numbers. It is obvious what is happening. Some people have made some foolish decisions. The chairman is asking, what do we do about it? It is here, we

better do something about it, because folks making those decisions, folks other than yourself, are not making the right decisions, at least not the right decisions in the interest of tax administration and the interest of the country.

Mr. GUARINI. Mr. Chairman, may I make an observation? There are, I understand, over 175 million tax returns that were filed last year. The workload gets increasingly more heavy. Is the IRS contemplating any creative, resourceful, implementing of new ideas as to how to tackle this problem? Are we only going to continue going down this path of creating a greater crisis, or is there a better way of doing it? How are we making the use of personnel by having all the returns filed on April 15, 100 million of them, and having corporation returns filed on March 15, if it is not a specific change of the filing date?

Is there a better way of doing things? Should people file returns on their birthday instead of everybody filing a return on the same date, where you create a tremendous work load for a limited period of time and then the rest of the time you are all spaced out? Do we have a better way of doing things? Is there any consideration being given as to how to better manage our personnel, how to better make our collections, how to better do our auditing?

Mr. OWENS. I think there are a number of things we are doing now, that we are testing. I would say, in terms of the staggered filing you referred to, certainly that would be helpful if it were to the point we were receiving returns throughout the year, no question about that. You would level the workload in terms of receipts, in terms of the output and so forth.

There are, as you know, a lot of transition rules in there as to how you make that happen and what effect it has on the businesses. It may require them to provide data at a different time of the year, depending on whatever time was selected.

One of the areas that we tested this past filing year, which we think has a great deal of potential, is electronic filing. We received about 26,000 returns through electronic filing where we do not get the paper, and, of course, when you do that, there are a lot of resources that are saved in the process. It is electronically sent to us, we don't get the tapes.

Mr. GUARINI. The more you get into computers, the more you seem to get into trouble.

Mr. OWENS. I think when things go wrong, they really go wrong.

Mr. GUARINI. And we can't afford to take the risk of—

Mr. OWENS. That is exactly what information technology is doing, not only with the Revenue Service but anywhere else. When things go wrong, they go wrong in a big way.

Mr. SCHULZE. Did I understand you correctly; you said the staggered filing would be beneficial, because in all of our discussions in the past, I understand that the feeling was that—at least at this point in computerization—that it would not. Perhaps some day downstream it held some promise, but at this point it was not a solution. Now, if that has changed, I would like to know.

Mr. OWENS. What I was trying to convey is that it might be the ideal situation we would like to have in terms of when you receive the work and when you handle the work. Certainly that would be better than getting lots at one time. But the practicality I think is

still open to question—whether or not it is feasible with all of the problems it will bring on us, on the American people, and the businesses.

Mr. SCHULZE. Thank you. Thank you, Mr. Chairman.

Chairman PICKLE. Thank you very much, Mr. Owens. We welcome you again to this committee as Acting Commissioner. I hope as we go through the next panel, you or some of your gentlemen can stay. We may have an interesting recitation now on this same subject, and we might have some of you gentlemen available for response.

Mr. OWENS. Certainly we will have some of the people who are here stay, Mr. Chairman. We are interested in what they have to say and what you have to say. We appreciate the assistance you have provided to us.

Chairman PICKLE. Thank you.

[Correspondence containing questions and answers subsequent to the hearing follows:]

[illegible][illegible]

U.S. HOUSE OF REPRESENTATIVES

WASHINGTON DC 20518

SUBCOMMITTEE ON OVERSIGHT

May 19, 1986

The Honorable James Owens
Acting Commissioner:
Internal Revenue Service
1111 Constitution Avenue, N. W.
Washington, D. C. 20224

Dear Mr. Owens:

I am writing in follow-up to the Subcommittee on Oversight's May 12, 1986 hearing on the Internal Revenue Service's FY 1987 Budget Request. Please provide detailed information on the following:

- (1) What is the maximum capacity of the IRS, in terms of both staffing and funding, to assimilate and absorb additional resources above the levels proposed in the Administration's FY 1987 Budget request, which could be used effectively and productively to improve tax administration and raise additional revenues?
- (a) How would these additional resources be allocated among various major programs, ranked by priority and by appropriations accounts?
- (b) Please briefly describe the impact of such additional allocations on tax administration, including:
- (i) cost to yield ratios for each allocation, as well as total cost and yield;
 - (ii) service to taxpayers; and
 - (iii) quality improvements.

I would appreciate your expeditious response by Thursday, May 22, 1986. If you have any questions, please contact Rusty Guritz, Counsel, at 225-5522.

I look forward to working with you on this and other important matters.

Sincerely,

J. J. Pickle, Chairman
Subcommittee on Oversight

JJF/rgw

COMMISSIONER OF INTERNAL REVENUE

Washington, DC 20224

MAY 29 1986

RECEIVED

Honorable J.J. Pickle
 Chairman, Oversight Subcommittee
 House of Representatives
 1105 Longworth House Office Building
 Washington, DC 20515

MAY 29 1986

Ways and Means
 Subcommittee on Oversight

Dear Mr. Chairman:

This letter is in response to your May 19 request for information on the Internal Revenue Service's budget. Specifically, you asked the Service to supply an estimate of the maximum amount of resources of both staffing and funding that the IRS could assimilate effectively and productively.

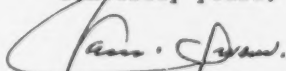
The Service could assimilate -- that is hire, train and deploy -- approximately 12,000 additional positions over the FY 87 budget request of 95,000 positions. Slightly over half of these positions would be devoted to other than direct revenue producing programs. These positions would be devoted to improving the processing of tax returns and resolving taxpayer account and tax law inquiries more expeditiously.

In terms of direct enforcement efforts, the Service could add 3,000 staff years in collection, 500 staff years in appeals and tax litigation, 500 staff years in examination, and 375 staff years in the information returns program. In total, we believe that these direct enforcement programs would yield between \$1.7 and \$1.8 billion. In addition to these enforcement personnel, approximately 800 additional staff years could be added in other enforcement areas, such as Criminal Investigation and compliance research. However, the IRS does not have yield data for these other enforcement activities. Details on the total staffing allocations are set forth in Enclosure A to this letter. To assimilate this volume of new positions, particularly in district offices, authority to hire would have to be received in advance of the fiscal year to cope with recruiting, space, and other significant logistical problems.

In addition to personnel, the Service estimates that it could assimilate \$75 million in automated data processing and systems modernization costs.

A summary description of these initiatives and their effect on the tax administration system is set forth in Enclosure B. I hope this information is responsive to your request.

Sincerely yours,



James I. Owens
 Acting Commissioner

Enclosures

Department of the Treasury Internal Revenue Service

INTERNAL REVENUE SERVICE
ADDITIONAL RESOURCES WHICH COULD BE ASSIMILATED IN FY 87
ABOVE THE PRESIDENT'S BUDGET REQUEST
(DOLLARS IN MILLIONS)

	SALARIES & EXPENSES		PROCESSING TAX RETURNS		EXAMINATION & APPEALS		INVESTIGATION, COLLECTION & TAXPAYER SERVICE		TOTAL		ADDITIONAL REVENUE COLLECTED OR ACCELERATED
	FTE	DOLLARS	FTE	DOLLARS	FTE	DOLLARS	FTE	DOLLARS	FTE	DOLLARS	
FY 1987 PRESIDENT'S BUDGET REQUEST	2,844	\$95.1	27,327	\$1,262.9	38,974	\$1,603.2	26,739	\$1,136.6	95,884	\$4,097.8	
ADDITIONAL RESOURCES:											
PROCESS TAX RETURNS			5,488	188.0			1,500	70.0	5,488	188.0	\$125
TAXPAYER SERVICE									1,500	70.0	
SUB-TOTAL: BASIC RESPONSIBILITIES			5,488	188.0			1,500	70.0	6,988	258.0	
SERVICE CENTER EXAMINATION					100	3.0			100	3.0	23
OFFICE AUDIT					400	13.0			400	13.0	52
SUB-TOTAL: EXAMINATION					500	16.0			500	16.0	
EMPLOYEE PLANS					125	5.0			125	5.0	
APPEALS & TAX LITIGATION					500	20.0			500	20.0	470
TAX FRAUD							585	30.0	585	30.0	
COLLECTION											
ACCOUNTS RECEIVABLE							2,000	90.0	2,000	90.0	730
DELINQUENT RETURNS							1,000	40.0	1,000	40.0	204
INFORMATION RETURNS *			375	15.0					375	15.0	160
COMPLIANCE RESEARCH					250	10.0			250	10.0	
SUB-TOTAL: ENFORCEMENT			375	15.0	1,375	51.0	3,585	160.0	5,335	226.0	\$1,764
STATISTICS OF INCOME											
INSPECTION											
TOTAL STAFFING											
ADP AND SYSTEMS MODERNIZATION			50	2.0			125	5.0	50	2.0	
TOTAL ADDITIONAL RESOURCES			5,985	197.0	1,375	51.0	5,210	235.0	12,490	483.0	
									0	75.0	
			5,985	197.0	1,375	51.0	5,210	235.0	12,490	483.0	
GRAND TOTAL	2,844	\$95.1	33,232	\$1,501.4	40,349	\$1,664.7	31,949	\$1,394.6	107,574	\$4,655.8	

* THE SERVICE COULD ASSIMILATE AN ADDITIONAL 1500 POSITIONS IN THE INFORMATION RETURNS PROGRAM, EFFECTIVE JULY 1, 1987. THIS RESULTS IN A FTE COMPUTATION OF 375.

INTERNAL REVENUE SERVICE
EXPLANATION OF ADDITIONAL RESOURCES WHICH COULD BE ASSIMILATED
IN FY 87 ABOVE THE PRESIDENT'S BUDGET REQUEST

PROCESS TAX RETURNS

5,480 positions and \$180 million

The Service could assimilate additional resources in its ten service centers. These additional resources would be used to:

- compensate for the continued decline in our ability to attract and retain a seasonal workforce;
- provide fully for the training of new and experienced employees;
- maintain quality improvement efforts begun in FY 1986;
- ensure timely posting of data from tax returns and payments to accounts;
- continue to reduce unpostable and adjustment inventories;
- provide better communication with taxpayers by improving correspondence procedures and practices;
- provide assistance to tax enforcement programs (e.g. pulling returns) and undertake expanded document matching (for example; matching amounts of withheld tax against employer quarterly returns, tracking deferred adverse tax consequences, etc.), which would result in \$ 125 million in additional revenue; and
- process increased volume of currency and cash transaction reports.

TAXPAYER SERVICE

1,500 positions and \$70 million

The Service could assimilate additional resources to assist taxpayers in meeting their filing responsibilities and in resolving their concerns on the status of their tax accounts. The additional 1,500 positions would be applied to telephone answering and would achieve an 85 percent level of service. Some 15 million additional taxpayers would be assisted.

INTERNAL REVENUE SERVICE
ADDITIONAL TAX ENFORCEMENT RESOURCES FOR FY 1987

EXAMINATION

500 positions and \$16 million

The Service could assimilate an additional 500 positions (above the 2,500 position increase in the President's FY 1987 budget) which would be devoted to:

— conducting correspondence examinations at the service centers involving issues such as unallowables, self-employment tax, multi-filers, etc. collecting an additional \$23 million in FY 1987 (100 positions);

— examining individual tax returns in the district offices thus increasing revenue collections in FY 1987 by \$52 million (400 positions);

EMPLOYEE PLANS

125 positions and \$5 million

The Service could assimilate 125 additional positions to reduce the backlog of requests for determination letters for employee plan as well as master and prototype plan sponsor amendments required by recent legislation (TEFRA, DEBRA & REA) (125 positions).

APPEALS & TAX LITIGATION

500 positions and \$20 million

The Service could utilize an additional 500 positions to :

— settle and litigate over 3,000 cases involving \$100,000 or more in potential tax liability (200 positions);

— settle and litigate 6,500 cases involving \$10,000 - \$20,000, primarily individual tax returns, currently in inventory and flowing from the increased correspondence and district office examinations (300 positions).

By closing these cases, the Service would accelerate collection of tax revenues by \$470 million in FY 1987.

TAX FRAUD

585 positions and \$30 million

The Service could devote an additional 585 positions toward investigating cases involving foreign transactions and bank accounts which have potential for large amounts of unreported tax liabilities.

-3-

COLLECTION

3,000 positions and \$130 million

The Service could assimilate an 3,000 additional positions in FY 1987 to devote to:

— collecting taxes owed but not paid thus reducing the inventory of accounts receivables. About \$730 million would be collected (2,000 positions).

— examining employment tax returns. These examinations would be conducted by revenue officers in connection with their work on securing delinquent returns from employers. An additional \$204 million would be collected in FY 1987 (1,000 positions).

DOCUMENT MATCHING

375 positions and \$15 million

The Service could assimilate an additional 1,500 positions in FY 1987 to follow-up on all instances of unreported income identified through matching. However, because of the nature of the processing cycle the Service would not be able to effect this increase until July 1, 1987 thus realizing only 375 Full Time Equivalent (FTE). The additional resources would increase revenue collections annually by \$348 million, of which \$160 million would be collected in FY 1987.

COMPLIANCE RESEARCH

250 positions and \$10 million

The Service could assimilate an additional 250 positions to increase research in tax compliance.

J.J. PICKLE, TEXAS, CHAIRMAN
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BETH KUNITZ, SUBCOMMITTEE STAFF DIRECTOR

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

WASHINGTON, DC 20515

SUBCOMMITTEE ON OVERSIGHT

June 4, 1986

The Honorable James I. Owens
Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Dear Mr. Owens:

Enclosed are additional questions that will provide a more complete record for the Subcommittee on Oversight's May 12, 1986, hearing on the Administration's proposed FY 1987 Budget for the IRS. I would appreciate receiving information in response to each question, taking into account the Service's recent reassessment of its budgetary needs and allocation of resources, which you referred to during hearing testimony.

Please respond to these questions no later than July 10, 1986. If you have any questions, please contact Rusty Guritz, Counsel, or Thomas H. Meyerer, Assistant Counsel of the Subcommittee staff at 225-5522.

Sincerely,

J. J. Pickle, Chairman
Subcommittee on Oversight

JJP/bkk

Enclosure

COMMISSIONER OF INTERNAL REVENUE

Washington, DC 20224

The Honorable J. J. Pickle
Chairman, Oversight Subcommittee
House Committee on Ways and Means
1105 Longworth House Office Building
Washington, DC 20515

AUG 11 1986 RECEIVED

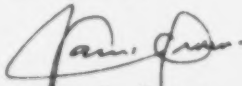
AUG 12 1986
Ways and Means
Subcommittee on Oversight

Dear Mr. Chairman:

Enclosed are responses to the questions posed in your
letter dated June 4, 1986.

I trust this information responds to all your remaining
questions on the budget.

Sincerely,



James I. Owens
Acting Commissioner

Enclosure

SECTION I: OVERVIEW

1. The IRS sent a budget request to Treasury for 98,000 staff positions and \$4.3 billion. The budget you have submitted to the Congress requests 3,000 fewer positions and \$194 million less funding.

- (a) What happened?

In the budget review process the IRS FY 1987 request was scaled back by 3,000 positions and \$194 million. The Congressional submission nevertheless represented an increase of 1,360 positions and \$272 million approved for the Internal Revenue Service as part of the President's budget request for FY 1987.

- (b) Why did you think you needed 3,000 more positions and \$194 million more funding?

The Service had requested the additional positions to expand and improve operations in most IRS activities.

- (c) What activities will you not do under OMB's budget which you would have done under yours?

Under the Administration's budget allowance the Service did not receive funding for:

- expanded correspondence with taxpayers from IRS service centers pertaining to interest calculations and other adjustments (695 positions and \$21 million);
- an 85% level of telephone answering for taxpayer service (1,000 positions and \$45.7 million);
- more staff to investigate tax fraud (270 positions and \$14 million);
- resources to track and follow up on deferred adverse tax consequences and alternative tax strategies (408 positions and \$12 million);
- compliance research (125 positions and \$7 million);
- support and follow-through work related to the Examination revenue initiative (245 positions and \$10 million);
- staff to process tax returns (290 positions and \$8 million);
- resources to institute a full scale effort to secure correct taxpayer identification numbers (TIN's) under the information returns program (128 positions and \$7 million);

- ADP and systems modernization initiatives (\$58 million); and
- resources for support services and training (\$14 million).

- (d) How much revenue could be brought in under your (IRS) proposal that will not be brought in under OMB's proposal?

The IRS FY 1987 budget as proposed to the Administration would have brought in \$38.7 billion from direct enforcement of the tax laws (i.e. examination, collection, document matching). The budget as approved by the Administration will produce \$38.1 billion.

2. To what extent is the FY 1987 budget request based on the timely approval of the FY 1986 supplemental, which would add 6,950 positions and a net of \$183.4 million after reduction under Gramm-Rudman-Hollings?

- (a) If the supplemental is not approved by the beginning of FY 1987, how will this affect the FY 1987 budget request?

The supplemental was signed by the President on July 2, well before the beginning of the next fiscal year. As a result, there should be no significant adverse impact on program accomplishments next year. However, resources and program delivery are dependent upon timely enactment of appropriations for FY 1987.

- (b) How will the IRS be affected if the supplemental is not approved by June 1, 1986? July 1, 1986? August 1, 1986? September 1, 1986?

Because the funds requested in the supplemental were for filing season operations, maintenance of planned revenue program levels and mandatory costs, it was necessary for the Service to spend in anticipation of an approved supplemental. On March 18, 1986, the Office of Management and Budget advised Congress of an impending fourth quarter deficiency.

Secretary Baker's April 30 letter to Chairman Pickle outlined actions the Service would have been compelled to take if the appropriation were too long delayed or not approved.

In order to slow its rate of expenditure while awaiting approval of the supplemental, the Service restricted hiring in most programs, cut back overtime, and deferred spending for office equipment, supplies, services and ADP. Now that the supplemental has been passed, the Service has quickly resumed normal operations and is proceeding with advance hiring for the FY 1987 revenue initiative, as provided for in the supplemental.

3. How would the Service allocate additional staffing over the authorized FY 1987 levels at each of the following levels:

- (a) 500 additional staff?
- (b) 1,500 additional staff?
- (c) 3,500 additional staff?
- (d) 5,000 additional staff?
- (e) What would the cost be for each level?
- (f) What would the yield be for each level?
- (g) What would the yield-to-cost ratio be at each level?

Based on the FY 1986 filing season, we are reassessing our staffing needs for FY 1987 in tax processing and taxpayer service. Assuming these needs are resolved, the Service would apply additional staffing in tax enforcement, prioritized based on marginal yield to cost, as follows:

<u>Program</u>	<u>Positions</u>	<u>(millions)</u>		<u>Yield to Cost</u>
		<u>Cost</u>	<u>Yield</u>	
Service Center correspondence examinations	100	\$ 3	\$ 80	27:1
Appeals and Tax Litigation	500	\$20	\$470	24:1
Accounts Receivable	500	\$23	\$270	12:1
Accounts Receivable	500	\$23	\$225	10:1
Information Returns	375	\$15	\$121	8:1
Accounts Receivable	500	\$23	\$135	6:1
Delinquent Returns	500	\$20	\$120	6:1
Accounts Receivable	500	\$23	\$112	5:1
Delinquent Returns	500	\$20	\$ 84	4:1
Office Examination	<u>400</u>	<u>\$13</u>	<u>\$ 55</u>	<u>4:1</u>
Total	4,375	\$181	\$1,672	9:1

4. Although the FY 1987 budget request provides for an increase of 1,360 positions, there are 1,708 authorized FY 1986 permanent positions that remain unfilled, and 1,775 estimated unfilled permanent positions for FY 1987? How then do you justify seeking 1,360 additional positions?

Due to selective placement procedures, there is normally a time lag ("lapse") between the loss of a permanent employee and the arrival of the replacement. Therefore, if the IRS managed its hiring on a one-to-one basis with average positions authorized, it would underdeliver the budgeted average positions by the accumulated delays in filling vacancies. Instead, the IRS controls the delivery of staffing resources through the authorization of additional permanent positions. This management tool permits the IRS to anticipate the delays by allocating more permanent positions and to deliver budgeted average positions necessary to accomplish the work. At any time during the fiscal year there will be a lapse between the number of permanent positions authorized and the number of persons actually employed (on rolls). The vacancy rate -- about 2% -- is not unusual for an organization of the size and complexity of the Internal Revenue Service.

The net additional 1,360 average positions are being requested to increase the examination of tax returns. The supplemental for FY 1986, which was recently approved by the Congress, provides funds for IRS to begin hiring additional agents this summer, in advance of the FY 1987 budget. As a result, there should be no difficulty in recruiting employees and filling the additional positions requested.

5. What is the IRS's most current estimate of the value of one percentage increase in voluntary compliance in FY 1987?

Our latest estimates of the legal sector income tax gap show a gap of \$103 billion and a compliance rate of 81.5 percent for FY 1987. This works out to about \$6 billion of tax not voluntarily paid per percentage point of noncompliance.

6. A non-enforcement IRS program of particular interest to the Congress involves Taxpayer Service.

- (a) What would the cost and program effects be for expanding Taxpayer Service at each of the following staffing levels above that proposed in the Administration's FY 1987 budget request: 200, 400, 600, 800, and 1,000 additional staffing?

-5-

Increasing Taxpayer Service staffing levels above that proposed in the Administration's FY 1987 budget request would affect the number of taxpayers we would be able to assist on our toll-free telephone system. The Administration's FY 1987 budget request (4,860 positions) would permit us to assist approximately 35 million taxpayers. The total taxpayers the additional positions would allow us to assist are outlined as follows:

- 200 positions -- 36.9 million taxpayers (\$ 9.1 million)
- 400 positions -- 38.9 million taxpayers (\$18.3 million)
- 600 positions -- 40.8 million taxpayers (\$27.4 million)
- 800 positions -- 42.8 million taxpayers (\$36.6 million)
- 1,000 positions -- 44.8 million taxpayers (\$45.7 million)

We estimate that our cost per position, including salary, benefits, and all support costs, is approximately \$45,700. The figures in parentheses reflect the dollar costs for the additional staff.

- (b) Under the FY 1987 proposal, what types of taxpayer service would be provided? Has this changed from prior years?

In FY 1987, Taxpayer Service will conduct active toll-free telephone, walk-in office, correspondence, and taxpayer information/education programs. This year Taxpayer Service piloted an expanded on-line account adjustment program that is designed to resolve a greater number of taxpayer account related calls on the first contact. Next year, given the necessary staff and equipment, we plan to extend this program nationwide.

- (c) What does IRS consider to be the optimal level of percentage of taxpayers assisted?

Assisting approximately 85 percent of the people who call us for help in any given week is the optimal service level at which the IRS can provide high quality assistance to taxpayers while achieving the best utilization of staff. An 85 percent service level will increase the accessibility of telephone assistance and inform taxpayers of their responsibilities by providing service which will help them meet their tax obligations.

SECTION II: RETURNS PROCESSING AND COMPUTERS

1. In your budget you increase the funds available for Computer Services by \$39.7 million to \$306.2 million. Also, the Office of the Assistant Commissioner (Tax System Redesign) has recently been established.

- (a) Does this reflect a re-emphasis in this area?

The increase in ADP funds will be used to continue implementation of ADP and systems modernization initiatives begun in prior years. This reflects a continuing emphasis by the Service on acquiring ADP equipment to more efficiently carry out its tax administration responsibilities.

Tax System Redesign's (TSR) portion of the budget increase is \$2.5 million, which provides funds for staffing and the continuation of vendors' work on the automated documentation system for tax administration. As a result of a change in strategy, TSR will no longer be a project based on acquiring a single redesigned tax system. Instead, TSR will pursue a redesigned, computer-based tax administration system by implementing several initiatives which are being considered by the Administration in the Service's FY 1988 Information Systems Plan. The Office of the Assistant Commissioner (Tax System Redesign) was established on October 1, 1985.

- (b) To what extent will there be a reduction in FY 1987 of selected ADP and systems modernization expenditures as a result of Gramm-Rudman-Hollings?

The President's budget request for FY 1987 meets the deficit reduction target (\$144 billion) required under Gramm-Rudman-Hollings. Should a Gramm-Rudman-Hollings reduction be necessary, the application of cuts to specific programs would depend on the magnitude of the reduction and the Service's overall budget priorities.

- (c) Is your decision not to pursue the acquisition of the Capacity Enhancement for the Processing System (CEPS) reflected in the budget request figures?

CEPS acquisition, originally planned as a separate interim measure, was cancelled and the computer system requirements for additional processing capacity were merged with TSR requirements. The Service's budget was not changed in total since the funds are being used to support current tax processing ADP equipment.

- (d) Is the additional cost of \$58 million incurred in awarding the contract to Sysorex/IBM for terminals and front end processors reflected in the budget request?

The \$58 million difference between the Sysorex and Computer Systems and Resources contracts occurs over the contract life of seven years, not one year. The additional FY 1987 cost of the Sysorex contract is not currently reflected in our budget request. We are working with the Administration to reassess this situation.

2. Despite the dismal 1985 tax filing season and the supplemental request of 5,558 positions and \$140.23 million to restore the effectiveness of tax processing, the budget request calls for a decrease of 1,590 positions and an increase of only \$9.40 million. How can you justify this resource request when the IRS will process 3.5 million more tax returns and supplemental documents than it did in FY 1986?

The FY 1987 budget request includes 473 positions and \$10.5 million to process the additional tax returns and supplemental documents projected for FY 1986. The latest returns volume forecast projects an additional 2.8 million more primary returns and supplemental documents than originally estimated in the FY 1987 budget request. We are currently reassessing this with the Administration to ensure that these additional returns are processed timely and efficiently.

The net reduction of 1,590 positions in the budget is composed of a reduction of 2,733 positions (which were received in FY 1986 for one year only to improve the quality of service center operations and reduce inventory levels) partially offset by increases of 1143 positions, including those in returns processing to cover increased number of returns filed (473 positions) and increased document matching (660 positions).

3. Do you plan to change the current Service Center computers in order to have a greater capacity?

- (a) Exactly when do you plan to make this change?

Full installation and implementation to replace the existing systems is planned by 1994.

- (b) Do you have enough capacity on your existing computers to handle the current workload? Next year's workload?

Service projections, and independent projections done by the General Accounting Office, show that the service centers will have adequate capacity to handle the anticipated workload for the remainder of 1986 and all of 1987. Any additional workload resulting from new legislation has not yet been determined.

- (c) Does the budget provide sufficient resources to maintain the current computer systems?

Because of the corrective and quality enhancement steps taken to address the service center problems that occurred during the 1985 filing season, the FY 1987 budget may not contain sufficient funding. The Service is working with the Administration on this issue.

4. Are there plans to replace the computers at the National Computer Center (NCC)? When this occurs do you plan to convert your programming from assembly to COBOL or some other higher level language?

The Service intends to modernize the tax processing system through a redesign of the master file which is located at the National Computer Center. One of the goals of the redesign is to convert the master file assembly language to a higher level language. A fully competitive conversion process may well result in the replacement of existing equipment at NCC, although every effort will be made to use existing equipment wherever possible.

5. How much "down time" are you experiencing with your computers now?

During January 1986 through May 1986 there were 351 hours of downtime in the service centers on the Sperry 1100/80's and 90/40 equipment. This amounts to less than 1% of available system time during this period.

- (a) What are the causes?

Computer downtime has been experienced for several different reasons. The major categories of downtime the Service has experienced are hardware malfunctions, systems and applications software problems, operator errors, and environmental conditions.

(b) What steps are you taking to minimize it?

During the FY 1986 tax processing season, IRS negotiated with Sperry for on-site maintenance support on a temporary basis. IRS is presently in the process of negotiating a maintenance contract with Sperry to provide this support on a permanent basis. This contract will upgrade the maintenance provisions of several contracts that currently provide only on-call maintenance services so that on-site maintenance is provided.

The IRS negotiated with Sperry to provide site manager positions for the FY 1986 tax processing season. The site manager coordinates all Sperry activity, both hardware and software, and provides a single point of conduct for all Sperry support matters at each service center.

6. What are current service center inventory levels for block-out-of-balance, error resolution, unpostables, and correspondence. Are sufficient resources allocated in the budget request to bring down these figures to acceptable levels in the near future?

As of the end of June, the inventory levels are 105,601 for block-out-of-balance, 197,714 for error resolution, 1,593,940 for unpostables, and 1,196,393 for adjustments/correspondence. Although significant progress has been made in reducing a number of these critical inventories and returning them to manageable levels, further reductions are still required in the unpostables and adjustments/correspondence inventories.

Our FY 1987 budget request does not include sufficient resources to maintain and further reduce our critical inventories to acceptable levels. However, we are beginning discussions with the Administration regarding this shortfall.

SECTION III: EXAMINATION

1. The major revenue initiative in the budget request is for the examination of tax returns. Under this initiative, 2,500 positions are added for FY 1987 at a cost of \$94.4 million, but this will result in only 120,000 additional returns being examined, for an average of 48 additional returns per position. Further, 27.6 percent of the additional assessments will not be collected.

- (a) Is this initiative cost-effective?

Yes. Revenues for the three fiscal years of the initiative (FY 1987-1989) are estimated to be about \$600 million, \$1.5 billion, and \$2.6 billion, respectively, for total revenues of about \$4.7 billion.

- (b) What will happen to this initiative if the FY '86 supplemental request, for 722 positions and \$116.79 million to strengthen tax enforcement, is not approved?

Only a portion of the 722 positions are intended for Examination. If the supplemental had not been approved timely, training of the potential hires would have been delayed until FY 1987. This would would have decreased both yield and returns examined.

2. Looking at the trend in your examinations policy over the past few years, there has been a steady decline in the percentage of returns audited from 2.11 percent in FY 1980 to the 1.42 percent projected for FY 1987. Correspondingly, there has been a steady decline in the number of total examinations, from 2,046,000 in FY 1980 to 1,596,000 in FY 1987.

- (a) Does this mean that the Service feels there has been a decline in the number of returns which would be found deficient if audited?

No, this does not mean there has been a decline in the number of returns that are in need of examination. Rather, it is the result of several factors: (1) concentrating staff on the more difficult, more time consuming and more profitable returns, and (2) filings have increased faster than our resources, thus causing coverage to drop. During the period FY 1980 to FY

1985, the percent of returns examined went from 2.11% to 1.34%. During that same period, however, additional recommended tax and penalties increased from \$9.6 billion to \$17.7 billion.

- (b) If there are still significant numbers of unaudited returns which, if audited, would yield additional tax owed, why are you not auditing a greater percentage of them?

We examine those returns most in need of examination within the resources provided to us. The available resources are allocated essentially based on a marginal yield to cost analysis.

- (c) What would it cost to increase the 1987 audit coverage (the percentage of total tax returns audited) to the following percentage levels: 2 percent, 3 percent or 4 percent?

The cost to increase coverage to 2% is approximately \$175 million, 3% is approximately \$550 million, and to 4% is approximately \$1 billion. However, the Service would be unable in FY 1987 to hire, train, and effectively utilize the number of employees it would take to achieve even a 2% level. Examination's FY 1987 request represents the additional resource level that can be effectively utilized in one year. It would take several years of similar increases before the program would approach the levels of coverage contemplated in the question.

- (d) At what point does the level of auditing returns have a diminished value?

Because Examination uses a model based on marginal yield to cost analysis and ranks its workload on decreasing audit potential, each return has a diminished value compared to the previous return examined on a class-by-class basis. The point at which examining a return is not cost effective is the point at which the expected yield of that return is equal to the cost of auditing that return. For individual and corporate classes under current law this point is not reached on a class-by-class basis until the composite coverage exceeds 20%.

- (e) What is the maximum number of examination staff the IRS could absorb, (hire and train) in one year?

We currently estimate the total staff-years the Examination activity could absorb in one year to be approximately 3,000. These would be utilized for field audits, office audits, and service center correspondence contacts.

SECTION IV: COLLECTION

1. The FY 1987 budget request for Collection totals 16,068 positions and \$635.5 million, an increase of only 12 positions and \$28.3 million above FY 1986. In fact, proposed staffing for FY 1987 will be 2064 fewer positions than provided in 1985. Total dollars collected from accounts receivable will increase only 2.57 percent from FY 1986, and the closing active inventory of delinquent returns investigations will decrease by only 3.26 percent from FY 1986.

- (a) Why is there such a meager increase in Collection resources for FY 1986, especially when there is \$45.3 billion in accounts receivable inventory as of March 31, 1986?

At the time we were preparing our FY 1987 budget request we had not yet seen the dramatic growth in the accounts receivable inventory. In fact, as a result of the FY 1983 revenue initiative staffing increase, the active delinquent accounts in inventory had begun to stabilize both in dollar value and number of accounts. In addition, we were projecting that productivity gains from our major automation efforts would permit us to control accounts receivable without staffing increases.

- (b) Why is the accounts receivable inventory so high (\$45.3 billion in uncollected, but owed, taxes)?

It was not until the first two quarters of FY 1986 that we saw the large increase in accounts receivable. Most significantly, we attribute the growth in the accounts receivable inventory to an increase of over 6 million primary returns filed in 1985 (prior year growth was just over 1 million), concurrently with an increase in average balance due. As a result of the large volume increase, new billings of balance due notices increased about \$20 billion in 1985. The balance due on accounts in notice status represents about 40% of the total accounts receivable balance. To some extent, the adjustment and unpostable backlogs in the service centers have also contributed to the accounts receivable growth.

We are currently examining the accounts receivable inventory to determine what steps we should take to reduce the amount of delinquent taxes.

- (c) What objection do you have to devoting more resources to Collection?

We have no objections to devoting more resources to Collection. As part of the review mentioned above, we are examining what additional staffing should be directed to reducing the accounts receivable inventory.

- (d) How much money is being lost annually due to the expiration of the statute of limitations on collection? How many delinquent accounts does this represent?

The chart below reflects the amounts written off due to statute expiration for the last three years. The amount written off decreased by \$123 million in FY 1985 and total write-offs compared to gross revenue collections have fallen below FY 1983 levels. We believe our progress in this area is due to the improved ability our automation efforts have provided for contacting taxpayers.

(\$000s)	FY 1983	FY 1984	FY 1985
lost to statute expiration	\$595,000	\$757,000	\$634,000
accounts	419,000	426,000	425,000
gross revenue collections	\$627,000,000	\$680,000,000	\$742,000,000
statute expiration as % of gross revenue collections	.09%	.11%	.08%

- (e) How much money does the IRS collect annually in bankruptcy cases? What resources are allocated to this activity? Are more resources needed?

In FY 1985, the IRS collected over \$90 million in bankruptcy cases. Collection devoted 300 staff years to bankruptcy processing in FY 1985 and Counsel used 40 staff years. Collection has worked closely with Counsel, the United States Attorneys and the bankruptcy courts to streamline the processing and monitoring of bankruptcy cases. This has allowed us to fully protect the government's interest in an increasing number of bankruptcy cases without increasing resources.

2. How can you have an examination "revenue initiative" and not, at the same time, increase the Collection function?

- (a) Did not Collection initially request 81 additional staff years to permit follow-up on tax delinquencies resulting from the examination initiative?

Yes, in the initial budget proposed by the IRS, there was an increase of 81 positions for follow-up work resulting from the examination revenue initiative. However, in considering overall budgetary requirements, the Administration decided not to request these additional resources.

3. The computerized Automated Collection System (ACS) undoubtedly improves office operations and accelerates the collection of unpaid taxes.

- (a) What will be the staff savings produced by ACS in FY 1986? FY 1987?

The successful operation of ACS has enabled us to reduce the Collection staffing base by over 1,700 permanent positions during FY 1984 - FY 1986. No further staffing reductions will be made in FY 1987

- (b) What is the status of development of the new integrated system that will automate the remaining collection activities? When will it be implemented nationwide? What staff savings will it produce?

The development of the Integrated Collection System (ICS) is proceeding on schedule. The cost-benefit analysis as well as the hardware and software requirements have been completed and we are now beginning the procurement process. Our current plans provide for installation of two pilot sites in late FY 1987. We plan to phase in the other 18 sites over 12 months and expect to complete nationwide implementation of ICS by early FY 1989. Once ICS is fully operational we expect to save over 900 positions.

SECTION V: PROBLEM RESOLUTION PROGRAM

1. The Taxpayer Ombudsman is responsible for the nationwide management of the Problem Resolution Program (PRP), and for identifying and solving systemic problems within IRS. He also acts as an advocate for the taxpayer. His staff consists of National Office and field personnel.

- (a) What are the resources allocated to PRP for FY 1987 and from what activities are they allocated?

There are 211 staff years allocated for the Problem Resolution Program for FY 1987. This includes 16 positions for the National Office, which are part of Executive Direction. The remaining 196 staff years are allocated to the field as follows: 14 for regional offices, 139 for district offices and 42 for service centers. The field resources are prorated throughout the budget.

In addition to these staff years specifically allocated to PRP, over 50 additional staff years are furnished to PRP field offices from Resources Management (25), Examination (10), Collection (9), and Taxpayer Service (7). As the need arises, additional employees are detailed-in to PRP offices.

The staff years noted above are for the Problem Resolution Offices in each location, and do not include any staff years realized by caseworkers in the district and service center functions who actually work the cases for the Problem Resolution Coordinators in each function in the National Office, regional offices, districts and service centers. As directed by the Deputy Commissioner, all field executives are expected to utilize whatever staffing is necessary to assure the successful operation of all PRP objectives.

- (b) How do these resources compare with FY 1986? FY 1985?

In FY 1986, 210 staff years are allocated for PRP; in FY 1985, 208 staff years were allocated. This does not include the additional staff years diverted from other functions to the PRP offices in the field or the staff years spent by caseworkers and PRP Coordinators.

- (c) How many systemic problems did your office identify last year? How many have been resolved? What are some examples?

We do not keep a count of all systemic problems identified by the Problem Resolution Program nationwide. Many problems identified are local in nature and are not forwarded to the National Office. During FY 1985, a total of 286 systemic or procedural problems were identified nationwide that were reported to the National Office. While most of the corrective actions have been effected, some procedural/programming/forms changes are still in process.

In addition, PRP conducts advocacy reviews or studies which are aimed at preventing problems from occurring. During 1985 there were 13 National Office mandated advocacy studies and many other local or regional reviews or studies.

- (d) Is the PRP activity growing in importance in terms of what it accomplishes for the taxpayers?

The Problem Resolution Program has grown steadily in importance and impact since its inception in 1976. As the program has expanded and matured, the number of individual taxpayers directly assisted directly has grown dramatically, from 59,000 cases in FY 1977 (the first year of operation) to 506,000 cases in FY 1985. As the training and experience of Problem Resolution Officers has expanded and grown, the volume and quality of systemic problem identification and advocacy activities has greatly increased. These activities have had a major positive impact on taxpayers in general by preventing or eliminating the causes of problems and complaints.

2. What role does PRP play in the Returns Processing function?

The Problem Resolution Program plays an important role in the Returns Processing function. At the National Office level, the Problem Resolution Staff continually works with all phases of Returns Processing operations. Internal Revenue Manuals issued by Returns Processing which have taxpayer impact are reviewed and members of the PRP staff take part in all major studies or task forces dealing with Returns Processing operations. District and service center Problem Resolution Officers, as part of their problem analysis and advocacy responsibilities, continually work with Returns Processing functions and recommend changes and improvements.

SECTION VI: OTHER PROGRAMS

APPEALS AND TAX LITIGATION

An initiative is proposed under the budget request to reduce the number of tax shelter cases (representing 372,000 returns) now in inventory. Although an increase of 497 positions and \$28.8 million is requested, the Appeals ending cases inventory will increase 9.67 percent to 120,200, and the Tax Litigations ending case inventory will increase 17.99 percent to 125,900.

- (a) Are these inventory level increases acceptable?

Revised projections reflect a 9% increase in the FY 1987 ending nondocketed inventory and an increase in the docketed inventory of 10.2%. We think that these inventory levels are too high.

- (b) Would additional resources be cost-effective in bringing down these inventories?

Additional resources would be cost-effective in reducing inventory levels.

- (c) What percentage of the assessed tax liabilities that result from the tax shelter initiative will be collected? Is this cost-effective?

In FY 1987 it is estimated that \$636.3 million of tax liabilities resulting from the tax shelter initiative will be assessed and of this amount, approximately \$600 million will be eventually collected.

EMPLOYER PLANS AND EXEMPT ORGANIZATIONS

Resources of 2,393 positions and \$99.16 million are requested for Employee Plans and Exempt Organizations, which is a decrease of 8 positions and an increase of \$4.1 million over FY 1986. The examination coverage rate for employee plans will increase to .80 percent, as compared with .69 percent in FY 1986, and the rate for exempt organizations will decrease to 1.40 percent, as compared with the FY 1986 rate of 1.55 percent.

- (a) Are these examination coverage rates acceptable?

We believe that our FY 1987 resources will be sufficient to provide at least minimum coverage in all categories of returns.

- (b) Is the rate for exempt organizations adequate regarding the examination of private schools alone?

We do not anticipate that our level of resources will affect our ability to properly examine private schools. Any warranted increase in private school examinations could be accommodated by slightly decreasing examinations in other categories of exempt organizations.

TAXPAYER SERVICE

1. Taxpayer Service resources will decrease by 24 positions and \$1.15 million, for a total of 4,860 positions and \$210.09 million.

- (a) Given the importance of the toll-free telephone, walk-in and correspondence programs and the fact that there will be more taxpayers in FY 1987, how can you explain a decrease in resources for Taxpayer Service?

A realignment of functions unrelated to providing direct assistance to the public in the Taxpayer Service budget activity accounts for the net decrease of 24 positions in the Taxpayer Service staffing for FY 1987. However, the number of positions dedicated to providing assistance to the public will actually increase by 13 positions in FY 1987.

- (b) What will ensure timely, quality assistance to taxpayers?

A funding level which permits Taxpayer Service to help approximately 85 percent of those who call for help in any given week will provide taxpayers with quick access to telephone assistants and enhance the quality of service which we provide. More taxpayers will reach us for help--and have their questions answered--the first time they call.

2. I assume you agree that taxpayers contact the IRS Taxpayer Service office in their effort to comply with the tax laws. Further, the Congress has enacted very serious civil and criminal penalties for failure to comply with the tax laws.

- (a) Shouldn't we do everything possible to help taxpayers comply with the tax laws?

We agree the Service must do everything possible to encourage voluntary compliance among taxpayers. To this end, all Service activities are directed toward encouraging and reinforcing compliance with the tax laws. Our taxpayer service, public information, and taxpayer education activities, as well as forms and publications programs, are particularly aimed at informing and educating taxpayers so that they can comply voluntarily.

- (b) Especially since our system is based on voluntary compliance, isn't it critical that taxpayers be able to fully comply with the law?

We believe it is essential to provide taxpayers with the help they need to comply with a complicated tax system. To this end, Taxpayer Service provides help to people with questions about the tax laws; it provides tax refund information; and it helps taxpayers understand Service-generated notices and IRS collection procedures. This year, we began what we hope will become an expanded program to assist taxpayers with their account problems. We are also in the beginning phase of an initiative that will provide taxpayer assistants with automated tax law reference material and up-to-date account information through a program known as ATSS or Automated Taxpayer Service System. This automated system will equip taxpayer assistants to be more responsive to taxpayer inquiries.

TAX FRAUD INVESTIGATION

The resources for Tax Fraud Investigations total 4,408 positions and \$223.8 million, a decrease of 5 positions and an increase of \$13.0 million over FY 1986. Although the Special Enforcement Program (SEP) covers organized crime and narcotics trafficking, the number of SEP special agents will decrease by 107 positions, and the number of SEP tax fraud investigations initiated will decrease by 196 positions.

- (a) Given the Administration's firm commitment to fight organized crime and narcotics trafficking, why is the SEP function being cut?

The FY 1987 Criminal Investigation staffing and investigation levels reflect a decrease in the SEP area because of a serious compliance problem identified in the general enforcement program, i.e., abusive tax shelters.

Abusive tax shelters were identified as a compliance problem prior to the recently proposed tax reform legislation. If these changes are enacted, it appears the anticipated workload increase in the tax shelter area may not materialize. If this is the case, it may not be necessary to reduce resources devoted to SEP in FY 1987.

Criminal Investigation received an increase of 215 staff years in 1983 and an increase of 40 staff years in 1985 which were specifically targeted for the Organized Crime and Drug Enforcement Task Forces (OCDETF). Current plans call for devoting the same level of resources in FY 1987 as in FY 1986.

CI's participation in the Southwest Border Project, which involves narcotics trafficking and money laundering along the Mexican-American border, will also increase the amount of resources devoted to SEP.

- (b) Are the FY 1987 resources sufficient to handle the anticipated increases in currency and cash transaction report cases?

The FY 1986 supplemental, which was approved by the President on July 2, provided 255 positions to process currency and cash transaction reports based upon a projected volume of 3 million reports annually. For FY 1987, it is estimated that 4.5 million reports will be received. The Service is now reassessing the resource level for this workload.

ENFORCEMENT LITIGATION AND RULINGS

The Enforcement Litigation and Rulings activity which provides legal and technical support for the Collection and Tax Fraud Investigations functions, totals 1,403 positions and \$67 million, a decrease of 30 positions and an increase of \$1.1 million over FY 1986.

- (a) Given the importance of the Collection and Tax Fraud functions, why is there a reduction in staffing and an insignificant increase in funding for the activity that supports these functions?

The overall decrease of 30 positions was the net result of an increase of 7 positions in Enforcement Litigation and a reduction of 37 positions in Rulings. This reduction resulted from a reorganization and transfer of 24 positions to Appeals (to carry out valuation work) and a transfer of 13 positions to the Taxpayer Service Division (for correspondence).

- (b) Would not additional resources for the enforcement Litigation and Rulings activity be cost-effective in terms of collected revenues, given the need to support the Collection and Tax Fraud functions?

Additional resources would be cost effective for the Enforcement Litigation and Rulings activity.

SECTION VII: COMPUTER ACQUISITION AND FUNDING

1. Computer Expenditures for FY 1987

It is difficult in sorting through your budget submission to get a precise figure on how much the IRS has budgeted for computer equipment. According to figures provided to the Subcommittee, it appears that the IRS budget for FY 1987, assuming the enactment of the FY 1986 Supplemental, will provide \$243.9 million for computer equipment.

(a) Is this correct?

The FY 1987 budget request provides \$251.3 million for computer equipment. This amount includes lease, purchase and maintenance of computer and peripheral equipment, ADP supplies, and data processing services.

(b) Is this enough to meet the computer needs of the 1987 and 1988 tax filing seasons?

(c) Does the IRS have additional short term computer needs that are not reflected in this budget?

The Service has recently identified the need for additional resources to cover deficiencies in the tax processing systems, as well as to provide increased service at toll-free and walk-in sites. We are currently reassessing these needs with the Administration.

2. Installation of Front-End Processors

The front-end processor is the communications "link" between various programs, e.g., ACS (Automated Collection System), IDRS (Data in taxpayers accounts), ERS (On Line Error Correction System), and the mainframe computer in a Service Center. The controversy over the awarding of the contract for front end processors and other computer equipment (IDRS Terminal Replacement Phase II) has resulted in some changes affecting the installation schedule of the front end processors.

We understand that the IRS has made a significant change in the installation schedule. Originally four new front end processors were to be installed in the "highest volume" Service Centers (Atlanta, Ogden, Austin, and Fresno) before the 1987 filing season.

(a) Is it true that only two front end processors will be installed before 1987? One in a Service Center and the other at the National Computer Center?

Current plans provide that the only front-end processors installed before 1987 will be located at the National Computer Center and the Atlanta Service Center. Front-end processors will be installed in the remaining service centers from January 1987 through September 1987.

This implementation schedule is subject to revision based on our experience in Atlanta and NCC. We will carefully evaluate the impact of installing new equipment on processing operations before proceeding with installation during the filing season.

When the original contract was awarded to Computer Systems and Resources in October 1985, the project schedule included the installation at the four "high volume" service centers prior to January 1987. However, protests filed by the unsuccessful bidders with the GSA Board of Contract Appeals resulted in a delay of approximately four and a half months. This delay made installation in more than two centers in 1986 impossible.

- (b) If three high-volume Service Centers do not have new front end processors by 1987, will this cause tax return processing problems next year?

The front-end processors are used primarily for non-pipeline, realtime tax account research and adjustments. The largest volume of these transactions occurs between May and August. Our plan calls for installing front-end processors in the high-volume service centers before May.

- (c) The GAO is especially concerned about the front end processors. They believe that the front end processors in many Service Centers may "run out" of capacity during the 1987 filing season.

- (i) Does IRS disagree?
 (ii) If so, what steps can be taken to "make do"?

Yes, IRS disagrees. We expect to be able to process the IDRS workload in 1986 and 1987. Under the present project schedule, the new front-end processors will be installed in the large service centers prior to the 1987 peak in IDRS transaction volumes. Also, most service centers extend the realtime day to a minimum of 16 hours during the filing season. Close attention is also being paid to optimum balancing of terminals between

front-end processor ports. These and other measures relating to mainframe software will preserve our ability to process the workload.

- (d) How much money has been budgeted for the front end processors and the other equipment for the IDRS Terminal Replacement Phase II?

- (1) Is this figure for FY 1987 adequate in light of the fact that the new front end processors contract is \$58 million more than the original contract?

Funds are budgeted in the amount of \$7.4 million in FY 1987 to replace the front-end processors and Control Data Corporation terminals, and add some expansion terminals to the service center networks. This amount is not sufficient due to the higher cost of the Sysorex contract. We are working with the Administration to reassess this situation. The \$58 million difference between the original and Sysorex contracts is for the entire contract life of seven years, not one year.

- (11) Will the IRS ultimately need supplemental funds for this program over the FY 1987 budget amount.

We are currently working with the Administration to assess this question?

3. Future Computer Acquisitions in the FY 1987 Budget -- CEPS

According to testimony provided to the Subcommittee, the IRS planned to convert the mainframe computers to a new system in each of the 10 Service Centers during 1988. IRS said these computers would run out of capacity by that date. This conversion program was called CEPS (Capacity Enhancement for Processing Systems).

- (a) How much is budgeted for CEPS in the FY 1987 budget?

Approximately \$5 million in ADP resources has been included in the FY 1987 budget. These resources have been redirected to TSR and will be used to support Service Center Replacement System (SCRS) requirements.

- (b) The Subcommittee has received information that the IRS has cancelled CEPS and now will keep the existing mainframes in the Service Centers through 1990. Is this true?

Yes, the CEPS request for proposal (RFP), as originally planned, has been cancelled. The existing mainframes will be retained at least through 1990. TSR will pursue a redesigned computer-based system incorporating the requirements of CEPS.

- (c) What information did the IRS develop that led to the conclusion that there was no need to convert mainframes in the Service Centers by 1988? What changes are planned instead of the conversion of mainframes in 1988?

It has now been determined that the current systems could be continued beyond 1988 by using such measures as software optimization, data base purification and discipline, application growth restraint, and the off-loading of selected computer runs.

- (d) Is this decision irrevocable and/or final? If so, what happens to the money budgeted for CEPS in the FY '87 budget?

Yes. These funds will be used to partially offset the continuing cost of the additional equipment that was installed in the service centers and NCC to address the capacity problems encountered in the 1985 filing period.

4. Future Computer Acquisitions in FY 1987 Budget -- Tax System Redesign

The Tax System Redesign is described as the master plan in the areas of telecommunications and computers in the 1990's and beyond. It is supposedly the "roadmap" for future acquisitions for the IRS.

- (a) How much is budgeted for TSR?

In Fiscal Year 1987, \$16,714,000 has been budgeted for TSR.

- (b) Is TSR the "roadmap" for 1990's telecommunications and computer acquisitions for the IRS?

TSR is the Service's focal point for tax processing systems design, development and acquisition for the 1990's, including telecommunications and computer acquisitions which will form the framework for the future tax processing system.

- (c) If so, the Subcommittee has received disturbing reports that TSR milestones and planning dates have not been met. Further, it was reported that Treasury rejected the IRS's TSR acquisitions study last year because it was "too vague."

- (i) Is there a TSR plan that concretely maps out computer and telecommunications acquisitions for the 1990's? If so, please provide this subcommittee with a 10 page summary of TSR. This summary should state the types of equipment to be purchased, the projected dates of acquisitions, and planned dates of implementation and on-line use. Also, provide an estimated cost of each acquisition.

In December 1985, Treasury provided feedback to IRS concerning the proposed acquisition strategy for TSR and recommended several actions, including the creation of TSR goals and objectives and identification of interim ADP needs. This approach provides the Service with shorter-term results and positions the Service for a long-range TSR implementation.

This feedback from Treasury resulted in significant changes to our strategy, including significant modification to the strategy for the design. We are in the process of developing a management plan which integrates the tax administration initiatives that will establish the methodologies to be used for managing efforts for planning, project management, design and implementation of the tax administration system.

- (ii) Will TSR guide all interim computer and telecommunications procurements by the IRS or will these procurements proceed on an ad hoc basis?

TSR will oversee procurement efforts for major systems by reviewing Information System Proposals, setting and enforcing data standards, and building a Servicewide data dictionary to ensure that interim systems' standards fit into TSR's plans.

5. Responsibility for Computer Acquisitions

Computer changes and new technology are at the heart of the IRS. Yet, the GAO and even the IRS's own Internal Audit Division has commented unfavorably on the "diffuse decision making process" at the IRS regarding the computer systems.

In response to Subcommittee questions, the IRS indicated that two new groups were established to "increase management involvement". They are called the Automation Policy Board and the Automation Control Group. In addition, all new Automatic Data Processing (ADP) programs are placed under a new Projects Officer.

- (a) How are these offices funded and staffed?
- (b) What are their responsibilities?
- (c) Are the new groups directly responsible for specific computer systems or do they only serve an advisory role?
- (d) Please identify the single person or office responsible for overall computer acquisitions, installation, and evaluation.
- (e) If there is no central office, does the IRS disagree with the recommendation of GAO, EDS, Congress, IRS (Internal Audit) on the need for a central authority in the computer area? If so, why?

The Automation Policy Board (APB), established in 1982, is composed of the Deputy Commissioner (Chair), Associate Commissioner (Data Processing), Associate Commissioner (Operations), Associate Commissioner (Policy and Management), two Regional Commissioners (with rotating terms), and Deputy Chief Counsel. The APB provides broad direction for establishment of standards and practices for the acquisition, use, expansion and discontinuance of information systems equipment and services. It is responsible for overall information systems planning for the Service. There is no special funding associated with the operation of this committee. If staff work is necessary it is accomplished by the function with program responsibility for the issue in question.

An Automation Implementation Control Group (AICG) is established for each major project to oversee the development of implementation plans and monitor progress of those plans. Each Automation Implementation Control Group includes as a core group the three Associate Commissioners with the Associate whose function is sponsoring the project acting as the Chair. Ad hoc members include the Assistant Commissioner(s) of the major user function(s), the Project Manager, and the Assistant Commissioners of the support functions. The AICG is responsible for the execution of the system from the approval stage through successful operational testing. It keeps the Automation Policy Board apprised of progress. There is no special funding associated with the operation of these groups. Staff work is performed by the Project Office.

In addition to the Automation Implementation Control Group, a Project Office is established within the Assistant Commissioner's area whose program the system supports. This is consistent with Office of Management and Budget guidelines, Circular A-130, Management of Federal Information Resources. The Project Office handles daily management and operation of project implementation. These offices are comprised of a Project Manager and subordinate staff who have been reassigned from other areas. Funding for this staff is requested as part of the information systems budget initiative for the project being managed.

The Associate Commissioner (Data Processing) has overall responsibility for computer acquisitions, installation and evaluation. These responsibilities are carried out by the Assistant Commissioner (Computer Services).

COMMISSIONER OF INTERNAL REVENUE

Washington, DC 20224

JUN 11 1986

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JUN 12 1986

Ways and Means
Subcommittee on Oversight

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
House Ways and Means Committee
1105 Longworth Building
Washington, D.C. 20515

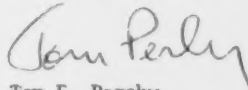
Dear Mr. Chairman:

As requested at the May 12 hearing on the IRS budget, enclosed is our first monthly report on certain service center and accounts receivable inventories. This information is the latest available to us at this time.

In the future, we plan to provide the service center portion of this report by about the middle of the month following the month for which the data was captured. In other words, we hope to be able to provide you by mid-June with data current through the end of May, and so on each month for the balance of the fiscal year. This two-week delay is necessary for consolidation and review of the data. The accounts receivable data is available from Collection quarterly, and will be updated again in July for the quarter ending in June.

With kind regards,

Sincerely,



Tom E. Persky
Assistant to the Commissioner
(Legislative Liaison)

Enclosure

MONTHLY INVENTORY REPORT

Service Center	Andover	Atlanta	Austin	Brookhaven	Cincinnati	Pasadena	Kansas City	Memphis	Ogden	Philadelphia	Totals
ADJUSTMENT INVENTORY AS OF MAY 9, 1986											
1986	94,885	149,525	206,927	133,329	66,439	193,540	51,236	99,908	101,896	52,206	1,109,891
1985	53,929	86,045	119,011	130,827	56,456	109,305	89,714	133,713	93,179	118,784	986,967
Differ.	40,956	63,476	87,916	2,502	9,983	84,235	(38,478)	(33,805)	8,717	(62,578)	122,924
Percent	75.9%	73.8%	73.9%	1.9%	17.7%	40.5%	-42.9%	-25.3%	9.4%	-54.5%	12.5
UNPOSTABLE INVENTORY AS OF MAY 16, 1986											
1986	110,371	298,930	238,408	191,722	127,751	234,252	111,602	129,705	125,559	188,109	1,756,489
1985	164,092	390,986	502,927	481,444	124,705	504,445	238,978	309,146	171,060	318,985	3,202,768
Differ.	(53,721)	(92,056)	(264,519)	(289,722)	3,046	(270,193)	(127,376)	(179,441)	(45,501)	(126,876)	(1,446,279)
Percent	-32.7%	-23.5%	-52.6%	-60.2%	2.4%	-53.6%	-53.3%	-56.0%	-26.6%	-40.3%	-45.2
RETURNS RECEIVED AND PROCESSED + (000) AS OF MAY 23, 1986											
CUMULATIVE RECEIPTS											
1986	10,135	10,716	10,412	8,050	10,076	9,727	9,844	9,775	10,163	7,798	96,696
1985	8,388	10,551	11,258	7,976	7,944	11,170	9,927	10,748	10,142	7,765	95,869
1984	8,109	9,968	10,842	7,777	7,752	10,639	9,665	10,437	10,010	7,445	92,644
CUMULATIVE PROCESSED											
1986	8,541	8,828	8,636	6,711	8,552	7,646	8,006	8,153	8,789	6,685	80,547
1985	6,678	8,312	9,146	6,632	6,535	8,952	7,726	8,814	8,066	5,857	76,518
1984	6,675	8,226	8,756	6,374	6,532	8,610	7,840	8,848	7,974	6,288	76,123
INVENTORY											
1986	1,594	1,888	1,776	1,339	1,524	2,081	1,838	1,622	1,374	1,113	16,149
1985	1,710	2,239	2,112	1,344	1,409	2,218	2,201	1,934	2,076	2,108	19,351

Chairman PICKLE. Now the Chair will call to the witness table Sheldon Cohen, Esq., Donald Alexander, Esq., and Jerome Kurtz, Esq.

Here we have the panel consisting of the voices of experience. It might even be confession time. We would like to hear from each one of you as to any comments you have with respect to budget and staffing operations within your former agency.

First I recognize Mr. Cohen, Sheldon Cohen.

**STATEMENT OF SHELDON S. COHEN, ESQ., FORMER
COMMISSIONER OF INTERNAL REVENUE**

Mr. COHEN. Thank you, Mr. Chairman.

I came to the Revenue Service as Commissioner 21 years ago, and I lived in the happy times when I can honestly say in every year compliance went up. That was considered with the introduction of computers. We had a President who believed in tax administration. It was a different day, and resources were different.

The committee was striking on a point today that you don't believe the budget problem lies in the Internal Revenue Service. I agree. I believe that over the last several years the career folks and the Commissioner were giving the Treasury and OMB their honest judgment as to what the problems were. They were being told that you will do it our way with less resources. Emerson's quotation is often misquoted, but Emerson's quotation is "A foolish consistency is the hobgoblins of little minds." In this case it was a foolish consistency you will get by each year with less and less resources.

The Revenue Service has done a good job in trying to work its way out of that terrible problem that came from the introduction of computers, the wrong computers at the wrong time in 1984-85. We had hearings on that last year. I won't dwell on that. But the Service is behind the eight ball now in that the supplemental appropriation is critical; it was mishandled both timewise and politicalwise on the Hill.

Another thing that this committee could look into that would simplify the life of whoever the Commissioner of Internal Revenue might be, and that is in the 1960's we had one appropriation. We had what was called a performance budget. I was held accountable to the Appropriations Committee and this committee as to how I spent that money. I had to report back if I made major alterations, but in effect I got one budget, not from different appropriations. It was about a quarter of what they get now. But I was authorized to spend that money as I best saw fit.

Now Congress, in its infinite wisdom, the Appropriations Committee, toward the end, about 1967, 1968 broke the budget into three or four appropriations. You can't imagine the work the Revenue Service goes through to juggle the interbudgetary constraints, because some functions fall within two areas, or there is a change. From time to time there is an emergency and you have to do with a little bit less money here, but you absolutely need it over there. You must come back and go through all the mechanics of those interbudgetary transfers, and it takes a great deal of time of the Commissioner and his staff that ought to be spent in straightening

out the problems you gentlemen have been discussing this morning.

A word or two about tax simplification. It won't help the audit and collection situation. It will help to stabilize the hemorrhaging. That is, it is my view that someone who has either not been filing returns or who has been filing returns with a large fudge factor is not going to begin filing honest returns the day after you enact a simplified tax law. I hope the simple law comes. It is needed. The wayward may be less likely to fall off the straight and narrow at that point because the tax rate is lower and the return is simpler to prepare.

It will take manpower and womanpower to go out and audit and collect all the tax that is due. This type of behavior has to be sought out; it has to be gleaned out of books, records, and financial data. There are a great many people who play the collection game, that is they wait for the Revenue Service to send a revenue officer out to see him before he pays his tax because he would rather spend the money on something else. They do not pay until they see that revenue officer. We have seen that time and time again. Therefore, you need auditors and collection personnel to follow up on these issues.

Now, as a number of you gentlemen raised this morning with Mr. Owens, the Revenue Service has less and less collection personnel per account outstanding as the years roll by. The number of accounts grow, the number of personnel assigned to collect those accounts falls. I can see it myself in my own practice, there are just not sufficient people. The OMB shortchanges the IRS on people, seeming to feel that the computer has become a crutch and will do the job. It won't. The Service has sent five or six different notices, each one of course becoming progressively more onerous. But you don't get to talk to a human being until that last final notice before seizure arrives, and then all of a sudden hopefully some day a revenue officer walks in and you can tell him "There is a computer glitch, and I haven't been able to straighten it out", or a particular taxpayer who hasn't paid, as the case might be.

I think the fact that the second notice brought in additional revenue at a relatively modest cost caused us to issue a second notice. As I was leaving the door, we were contemplating a third notice. Now I notice they are up to five or six. I am not positive of that, but it seems to me there are five or six notices before a human being ever intervenes in the process.

Now, the series of notices and the computer have become a crutch. I think that is one of the reasons for your increasing inventories of collection accounts. That is, the deadbeats of the world—you and I don't know there are five or six, but the deadbeats of the world know exactly how many there are, and they know what the tolerance level of the Service is. If the Service's tolerance level is \$50, they will run their account to \$49. They know exactly when they are going to spark a forced collection action.

The only way you are going to break this conduct is keep them off balance and have sufficient personnel. Whatever your tolerance level, every once in a while you can go different level. In other words, if you have a \$500 tolerance level, you would go to \$100 or some lesser number to throw people off balance. The enforcement

patterns of the Service are like any other enforcement patterns; they don't have to change. If a thief knows the night watchman's patterns, he can break in at a point when the night watchman is away. That is the same thing that is happening here.

This committee is to be commended. For the last several years, it has hammered away at the Commissioner and indirectly at OMB and the White House on the inadequacy of the resources supplied to the Internal Revenue Service. At a time of budget deficit, it is absolutely crucial the Service get every dollar the tax system was designed to collect. As long as the Commissioner and his staff come back and say, "Yes, if we had 'x' more dollars we could bring in a reasonable multiple of that", they ought to receive the needed funds, assuming they are operating efficiently.

I believe the Service is attempting to operate efficiently, and it has been short changed. You look at the last 4 or 5 years, you will notice in most areas the absolute numbers are down. The number of revenue agents and office auditors on the board at the Service the last time I looked is only 1,000 more than when I left 17 years ago. Now there is something wrong with that system.

Thank you, Mr. Chairman.

Chairman PICKLE. Thank you, Mr. Cohen.

Now, Mr. Alexander, Esquire.

STATEMENT OF DONALD C. ALEXANDER, ESQ., FORMER COMMISSIONER OF INTERNAL REVENUE

Mr. ALEXANDER. Thank you, Mr. Chairman, for the Esquire. And thank you for having this hearing.

You said when you introduced the hearing the Internal Revenue Service must operate efficiently. As Congressman Schulze pointed out, throwing money at a problem doesn't necessarily solve the problem. Unfortunately, the Internal Revenue Service is in a real bind in 1986, and unless it has that supplemental, the Service and the taxpayers of this country are in deep trouble because when the Service is in trouble, the taxpayers are in trouble, too.

So whatever the reason for the problem that you described this morning, Mr. Chairman—the lateness of the request—I surely hope that there will be a way of meeting the Service's needs as promptly as possible. I am glad the House passed the supplemental, even though it might have some baggage on it that might concern the White House. I hope if that comes to an impasse, the IRS supplemental will be broken out and passed, because they have to have the money. They spent it on trying to get a good filing season, and I hope the new Commissioner is not faced with the job of dismantling the Service. I think you will have a very fine new Commissioner, and I hope he comes on very soon.

Congressman Dorgan, you asked about the no change percentage, because you are concerned, and properly so, about the effectiveness of the examination program at IRS. Well, the no change percentage is down, and that could indicate a couple of things. No. 1, a better return selection; No. 2, worse taxpayer compliance. I am quite skeptical about the results of the 1982 Taxpayer Compliance Measurement Program that is showing a decline in the rate of non-compliance; in fact, possibly an increase in compliance in certain

categories. It suggests that compliance is falling in the categories where it matters the most; those in high income, complex returns.

What do you do about it? Well, first, the IRS, in its 1987 appropriation had to ask for a substantial increase in examination and in appeals and litigation. That is good. And I hope you make sure that it works by continued oversight hearings—oversight is a very healthy thing for a commissioner. I asked for it once. It turned out to be kind of a mistake as I got a lot more than I wanted. But I hope that you find the time, with all the demands on the Congress, to have continual oversight hearings, to inquire into the management of the Service, to inquire into its long-range planning, to inquire into how it measures efficiency and whether those measurements make any sense. Because the Service has an obligation to you just as you have an obligation to it during 1987.

In my prepared statement, I mention \$30 billion in overdue and uncollected taxes. Is it now \$45 billion, Mr. Dorgan? I don't know where that 15 came from, because last year—there is testimony in your last year's record that it was 30. So, that is a rather sizable and very puzzling and also a difficult increase if that is the case. Maybe last year we were low. Whatever, it doesn't make any sense to cut collection resources just as it doesn't make any sense to cut the Criminal Investigation Division.

Mr. Owens told you about the responsibility of that division, but he didn't tell you about the resources of the division. Resources have been cut. That cut should not be permitted to stay. More special agents are needed to cope with narcotics traffickers who are not inclined to pay their taxes, cope with organized crime figures who are not inclined to pay their taxes, and cope with the general public, some of whom I am sorry to say are not inclined to pay their taxes.

Finally, without repeating what is in my prepared statement, I notice the Senate Finance Committee has produced a very interesting, innovative initiative in coping with the problem that we are discussing this morning. They put IRS into a trust fund, and they are going to provide increased funding. The number that was handed out by the committee appears to be about \$2 billion higher than the IRS 1987 appropriation. I don't understand the difference, but I am sure there is a good explanation. Whatever, they propose to increase IRS' resources and take IRS out of the budget process by trust funding IRS. I commend that idea for a careful study in the House of Representatives, and if you find that to be a sound approach—it looks sound on the surface—I would hope you would adopt it, and that might solve some of the problems that have frustrated this committee over the years, as well as some of the problems that deeply troubled those of us who have been Commissioners of Internal Revenue in the past.

Thank you.

[The statement of Donald C. Alexander follows:]

STATEMENT OF
DONALD C. ALEXANDER
CADWALADER, WICKERSHAM & TAFT
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS,
U.S. HOUSE OF REPRESENTATIVES
CONCERNING
THE ADMINISTRATION'S FISCAL YEAR 1987 BUDGET PROPOSAL
RELATING TO THE INTERNAL REVENUE SERVICE AND THE 1986
SUPPLEMENTAL APPROPRIATION FOR THE INTERNAL REVENUE SERVICE
MAY 12, 1986

I am a partner in the law firm of Cadwalader, Wickersham & Taft and am appearing here at the request of the Subcommittee.

The Internal Revenue Service and our nation's tax system are in trouble, and it is essential that Congress promptly pass the 1986 supplemental appropriation that IRS has requested.

The 1986 filing season has cost IRS so much money that IRS will face a shut-down and taxpayers will face massive problems unless the supplemental appropriation is enacted. With last year's problems so recently in mind, the public should not be subjected to a tax system that is prevented from functioning adequately by a lack of funds. This is false economy; the damage done to the Internal Revenue Service, the tax system and taxpayers by lay-offs and other actions that IRS would have to take in the absence of the supplemental would vastly exceed any benefits from temporary savings in governmental expenditures. Not only would there be great losses in tax revenues, but also restoring IRS to a more adequate size would involve costs such as hiring and training new workers, which would exceed any short-lived cost savings. Moreover, and more important, rendering IRS incapable of performing its responsibilities necessarily endangers the tax revenues which provide over ninety percent of the receipts side of the budget. Therefore, applying Gramm-Rudman-Hollings to the Internal Revenue Service is counter-productive, and failing to pass the supplemental appropriation would be even more unwise.

The appropriation which IRS has requested for 1987 again falls short of the mark. While it calls for a much-needed increase in the Examination function and a concomitant increase in Appeals and Tax Litigation, it falls far short elsewhere. An example is Criminal Investigation Division, which has the vital responsibility of protecting the system against those who wilfully evade their tax responsibilities, whether the evader be a drug dealer or an ostensibly upright citizen. Although massive demands are made upon the Criminal Investigation Division to participate in the fight against narcotics trafficking and organized crime (participants in such activities rarely, if ever, meet their tax obligations), the resources available to carry on this important work and a similar effort against other tax evaders have been reduced substantially in recent years. Average positions of 4,686 in 1985 drop to 4,408 in the 1987 budget request. Fewer special agents will be called on to do more. This doesn't make sense. At a time of diminishing compliance with our tax laws and an ever-increasing revenue gap, it is essential that IRS have the resources to ferret out and prosecute those who wilfully evade their responsibilities to their country and their fellow citizens. The Criminal Investigation Division should be strengthened, not weakened.

In discussing the impact of Gramm-Rudman-Hollings, the budget document contends that revenues "should not be affected adversely", and states, "The impact of the Gramm-Rudman-Hollings reduction will fall heavily on administrative and support func-

tions." Implicit in this statement is the assumption that administrative and support functions are excessively staffed now; otherwise a cut in such functions would necessarily reduce the effectiveness of those supported and supervised. Many believe, with good reason, that support functions in the IRS have already been reduced too much and that further reductions in support might well seriously impair the efforts of revenue agents, revenue officers, special agents and attorneys. Moreover, a sound -- but not fat -- administrative structure is necessary to the sound functioning of an IRS unit. The suggestion that reducing administrative resources does not have a line effect is, at best, unrealistic. It is equally factitious to contend that "productivity improvements" will permit greater results from fewer people. Last year's filing period was, in part, a monument to such thinking.

Employee Plans and Exempt Organizations has again been cut. As I stated last year before this Subcommittee, it is essential that IRS deliver prompt and responsive guidance to those who must amend their employee plans to qualify under very complex and continually changing statutes. Rendering IRS unable to perform its regulatory functions with respect to both employee plans and exempt organizations is unacceptable.

Collection resources have been substantially reduced since 1985. According to recent estimates, about \$30,000,000,000 in federal taxes are overdue and unpaid. It is not hard to visualize the impact on the deficit if half of this could be collected. Automated systems and new techniques indeed assist the collection process, but they cannot compensate for inadequate resources. Returns Processing and Taxpayer Service must be kept at a level capable of fulfilling their vitally important work. The improvement in the 1986 filing period over that of 1985 shows what additional resources can do in the returns processing function. We should not slip back.

The budget document estimates a substantial decrease in IRS rulings to be issued and technical projects to be completed. As I stated last year, this is a step in the wrong direction. Our ever-changing federal tax laws are so complex and confusing that the public needs more guidance from IRS, not less. IRS technical functions are essential to the sound operation of our tax system, and it is regrettable that this vital function has been starved in recent years and deprived of the support which it must have to operate efficiently.

Mr. DORGAN [presiding]. Mr. Alexander, thank you.
Next is Mr. Kurtz.

**STATEMENT OF JEROME KURTZ, ESQ., FORMER COMMISSIONER
OF INTERNAL REVENUE**

Mr. KURTZ. Thank you.

I might comment that the Senate bill is, in one respect, a throw-back to the early days of the Internal Revenue. In the middle of the 19th century, they pointed out the Commissioner and collectors were paid on a commission basis, which seemed to produce good results.

Mr. ALEXANDER. The first Commissioner, of course, was paid on a commission basis, and I figure I would have made \$3 billion a year if I had been paid on the same basis. I am not suggesting we put Internal Revenue on commission. When Internal Revenue collects \$800 billion, a little of that might be set aside for the Internal Revenue Service.

Mr. DORGAN. Is \$3 billion more than you are now making?

Mr. ALEXANDER. Yes. Let's knock off the zeroes.

Mr. KURTZ. Obviously, the witnesses have pointed out, and as the committee has recognized, the Service finds itself in a mess right now. It has anticipated funds which it has not received. It has, in effect, spent the end of the year's money in the beginning of the year. Without criticizing whether that choice was wise—it probably was an essential choice—it now finds itself in a desperate situation.

The problem did not just arise. The IRS has been underfunded for years. Let me hasten to add—this administration did not invent underfunding the IRS, but it did develop it into a high art. The problem had gotten progressively worse over the years without much public attention.

When we had the disaster of the 1985 filing season, everyone became aware of the problem, and the Service came in for a supplemental to prevent it from happening again. It was essential that it not happen again. The IRS' image needs polishing, not tarnishing, and without this money to take care of the end of the year, the problems will be profound and will seriously hurt tax administration. This brings us to the year 1987 in which, it seems to me, the administration is doing exactly the same thing it did over the last 5 years, and that is underfunding the IRS.

The 1987 budget adds 1,360 positions, as I read the numbers, over the 1986 appropriation with the supplemental. That budget request talks about a major revenue initiative. The major revenue initiative adds 2,500 positions to examination, roughly 800 positions for document matching, 450 positions for tax shelters, all within a total increase of 1,390.

So, obviously, the major revenue initiative is pulling resources from other functions, and we have had that described. Fewer positions in return processing, fewer positions in collection, or at least a very modest increase. That obviously is pennywise and pound foolish.

The Service has, as Mr. Pickle pointed out, record backlogs in correspondence, in unpostables. Every one of us, I think, knows at least one taxpayer, and probably many who has related some

horror story about dealing with the IRS—an inability, after mountains of correspondence, to get an error straightened out, repeated phone calls that go unanswered and unreturned. The Service has a very, very poor image for service.

Now let me make clear that this is not due to any lack of dedication or ability of the people at the IRS. They are simply swamped. While throwing money does not solve all the problems, it would solve a lot of IRS' problems. Many of IRS' problems are due simply to an insufficient number of people to do the work that has to be done. There are over a million pieces of correspondence that haven't been answered. There is no magic as to how to answer that correspondence. Somebody has to read it and then do whatever research is involved, straighten the account out—do it. That is a million pieces of correspondence, and the most dedicated, able people in the world can't do it if there is not enough of them.

Enforcement has declined very dramatically to the point today where most people recognize the chances of being examined are remote, and if they are examined, it will probably lack thoroughness. What to do about it from the committee's point of view is obviously difficult.

One thing that I think is very important is that the IRS budget documents talk in terms of what a particular level of appropriation will accomplish. That is, "we will be able to answer so many phone calls, we will be able to process and so forth." What they don't address is what the goal is.

What is efficient tax administration? That is, someone calls on the telephone, how many times did the phone ring before someone answers it? At what time of the year? How many times did they have to call, and what does it take to produce that desired level of service? That is not to say the money automatically will be there to reach perfection, but there ought to be a measure of how far short the appropriation is falling. How many tax returns should be examined? What is a reasonable inventory of cases for an appeals officer to handle and with so many cases how long will it take them to dispose of the cases? How long does it take to get a ruling from the IRS? Four months, five months, is that acceptable? What should the goal be? It seems to me with those questions we can determine a norm and the how far short of the norm the appropriation is falling. Then the committee can reach informed judgments.

Let me add one or two other things. I think we all have to recognize that statistics on compliance are at best refined guesses. It is impossible, I would say, to measure what 100 million people are trying to hide, which is what we are doing when we measure non-compliance. So that little changes, 1 or 2 percentage points one way or the other, really cannot be regarded as significant.

Moreover, the statistics for compliance will always be 2 or 3 years behind. We don't know what compliance was like during 1985. Those returns were just filed. They are not going to be looked at until 1986 or 1987 or 1988, and the statistics won't be compiled until then. Whenever we talk about compliance trends we talk about information at best 3 or 4 years old. Extrapolating from that doesn't take account of things that may have happened in the interim.

The fact of the matter is that compliance is a problem. Whether it is 100 billion or 80 billion or up or down a little is irrelevant. It is a serious problem and a problem both because there are insufficient examinations and because people, I think, today, generally don't regard the IRS as efficient and effective, and that results from a variety of reasons.

I just want to make one other point, and that is the effect on tax reform. Again, I think if we have the kind of tax bill that came out of the Senate Finance Committee or the House or something in between, it is likely there will be considerable simplification, but before that will be felt by the IRS there will be considerable complexity. A new bill means changing from the existing system to the new system so any savings of resources won't come about for some years.

Also remember that the examinations of returns filed under a new system will not commence for several years. The IRS will continue to deal with the system we have today for some time and needs resources to cope with that.

[The prepared statement follows:]

WAYS & MEANS COMMITTEE
SUBCOMMITTEE ON OVERSIGHT

MONDAY, MAY 12, 1986

STATEMENT OF JEROME KURTZ

Mr. Chairman and Members of the Committee:

I appreciate your invitation to participate in this important hearing concerning the 1987 budget request of the Internal Revenue Service and its 1986 supplemental request. I am a lawyer in the Washington, D.C. office of Paul, Weiss, Rifkind, Wharton & Garrison and appear before this committee in my individual capacity. My interest in this subject stems from my tenure as Commissioner of Internal Revenue from 1977 to 1980.

The Internal Revenue Service today finds itself in a desperate situation which, if not cured, will undoubtedly have a profoundly damaging effect upon our tax system.

The Administration is not free from fault for this situation. Funding for the Service had been allowed to fall dramatically behind that necessary to keep pace with increasing workloads from 1980 through 1985 largely due to the Administration's failure to request adequate funds. The result has been a steady decline in audit coverage, a dramatic worsening of responsiveness and taxpayer service, and a steady increase in backlogs of all kinds. However, the effect was not clearly perceived by the general public until the 1985 filing season when those problems became notorious. That situation should have been anticipated. The number of personnel engaged in processing tax returns had declined from approximately 27,000 in 1978 to 21,000 in 1985 during which period the total workload, as measured by the number of returns filed and therefore requiring processing, increased substantially. While there may have been some efficiency gains during this period, they were clearly inadequate to compensate for the decline in work force and increased workload.

The Administration's 1986 budget request for the IRS did not provide for adequate additional resources to prevent a recurrence of the 1985 mess. The 1986 appropriation provided for a total of 86,489 average positions -- about 1000 fewer than available in 1985 (1985 provided for 88,508 average positions). The Administration, therefore, supported a request for a 1986 supplemental appropriation of \$340 million to provide 6,950 additional average positions, most of which were to be available for tax processing. That supplemental request had not been approved as the 1986 filing season approached, so in an attempt to avoid what was perceived -- probably accurately -- as impending disaster, the Service requested approval of a deficiency apportionment from OMB permitting it, in effect, to spend in advance funds which would otherwise be needed later in the year. In effect, the Internal Revenue Service anticipated the funds to be provided in the supplemental appropriation. This supplemental appropriation has not yet been approved. If it is not, the Service will find itself in the very uncomfortable position of having to make up the anticipated resources toward the end of the year by extremely drastic spending reductions including releasing thousands or tens of thousands of employees.

While there may be some sentiment to leave this problem on the Administration's doorstep on the grounds that

the blame belongs there, I submit there are more important considerations. It is more important, in my view, to avoid the impending crisis than it is to fix blame for the predicament or punish the alleged culprits.

A failure to approve the 1986 supplemental funding would cripple and demoralize the IRS, further tarnishing its image at a time when it needs polishing, and denying the taxpayers the minimum of fairness and service to which they are entitled.

The supplemental appropriation will provide 6,950 additional average positions boosting the total 1986 average positions to 93,724. While this work force may be sufficient to avoid calamities, it is far from adequate to administer our tax system appropriately. The fiscal year 1987 budget request adds only 1,360 positions leaving the IRS, in my view, grossly understaffed and underfunded. This budget request, in providing for a total increase of 1,360 positions, promises a "major revenue initiative" by adding 2,500 positions to returns examination, to be the first of three annual similar additions. There are also additions in other enforcement functions, for example, 795 positions for document matching, and 465 added positions for the tax shelter program. Since the total increase is only 1,360 positions, these enforcement additions come at the expense of other programs, mainly returns processing.

The 1976 budget request falls far short of moving the IRS toward becoming the effective, efficient organization that honest taxpayers deserve and have a right to expect. The continuing failure to fund the IRS adequately is shortsighted, uneconomic folly.

We are all aware of the serious and growing problem of noncompliance with our tax law and yet, when this "major revenue initiative" is fully implemented in three years, the percentage of returns examined will still be significantly less than it was ten years ago when it was an inadequate 2.5%. In 1987 it will be 1.42%.

But the examination program, indeed the entire enforcement program, is only one part of tax administration. Of at least equal importance to the overall effectiveness of the tax administration system is the public's perception of the efficiency and helpfulness of the IRS. I believe the preponderant view of the Service is just the opposite.

It seems that almost every taxpayer can relate some horror story about the virtual impossibility of getting an IRS error corrected -- stories of endless correspondence, unresponsiveness and insensitivity. How many unanswered pieces of correspondence does the IRS now have in inventory? Has anyone ever expressed satisfaction with IRS telephone assistance? Most who try to get help by telephone cannot get their calls answered. Similar problems exist in almost all areas. Let me hasten to say that I do not believe these problems are the result of any lack of dedication or ability of the great majority of IRS employees. The problems stem largely from the fact that there are simply too few people at IRS to do an adequate job. And the Administration is not facing that fact in its budget requests.

What these budget documents lack is any reference to what good tax administration requires and how far short of this mark the current budget request will leave the Service.

example: I submit, we should know what our goals are. For

- * How many tax returns should be examined?
- * What are manageable appeals inventories and Tax Court backlogs?
- * What would it take to be able to answer most correspondence and telephone calls promptly and accurately?

Only with this kind of information can the adequacy or lack of it of the Administration's budget request be judged.

I will be pleased to address any questions you may have. Thank you.

Mr. DORGAN. Thank you, Mr. Kurtz, and we thank all three of you for your perspective of this difficult problem, particularly from the background that you bring to it as former Commissioners of the Internal Revenue Service.

You were all here, I believe, during the testimony of Acting Commissioner Owens and probably saw, as I did, that the Commissioner is rightfully uncomfortable with some of the questions being asked because he does not have the financial say on what his budget request is to Congress. They put numbers together that represents their estimate of what ought to be done. That gets changed at Treasury, I assume. It gets changed at Office of Management and Budget, and maybe at the White House. Then it gets sent to Congress. But it is clear to me from all of that that the budget requests that have come finally from the administration have been inadequate at least, charitably, and what I called foolish, in areas such as revenues described for accounts receivable and several other areas of the budget.

Would you, knowing what you know about this situation today, describe the system in a crisis—the 18- to 19-percent tax gap, burgeoning accounts receivable, eroding confidence of the taxpayers in the fairness of the system—would you consider this a crisis at this point?

Mr. COHEN. I would. I think one of the factors you left out is the increasing Treasury intrusion into the management of the Internal Revenue Service. Heretofore the Internal Revenue Service has been quasi-autonomous. There is increasing intrusion of the Treasury both in budgetary and personnel management aspects. This is not to the good, and the confidence of the American people in the tax system is the thing that is driving this mercurial machine that produces the kind of revenue we are talking about.

What used to drive me to sleepless nights is the worry that anything I might do might destroy confidence in the tax system by 1 percent. That would cost more money than you could possibly bring in by your whole budget—and any of the things that we have been talking about this morning that destroy or erode the confidence that people have in the system is bound to bring more and more disrespect.

The Internal Revenue Service got to the point where they audit almost no individual returns except what they call must accounts. Now they are auditing tax shelters, and they are auditing a few other kinds, and they are auditing a lot of corporations, but garden variety taxpayers never see a revenue agent, no matter how good or bad their returns are. That is not healthy.

Mr. ALEXANDER. I want to separate that into two parts. First, I think as to 1986, you do have a crisis. You have a crisis for the reasons we discussed earlier. The supplemental really must be passed. The money has already been spent, and if there is not a crisis next week, there will be a crisis within the month.

As to the system as a whole, I am not sure we have the disaster characterization yet. All of us, as former Commissioner Cohen said, are seriously concerned about the health of the system, and the system is not healthy. Part of the problem is the budget process—not all of the problem, but part of it. You deserve a better and healthier system than you have and the Internal Revenue Service

is full of a lot of dedicated people that are trying to deliver that system, but as former Commissioner Kurtz said, they can't answer the million unanswered letters with inadequate resources, which will be further reduced by the 1987 budget. That, in my judgment, doesn't make sense.

Mr. KURTZ. I don't know at what point we pass crisis, but we are on the road there and there is nothing in these budgets, in the 1987 budget, that indicates that we are turning away from it.

I think there are extremely serious problems with the tax collection system. It is not being handled well. The problem is that once it goes over the edge, it will be very hard to pull it back, so that we want to stay away from reaching that crisis point. So much depends on confidence and other intangibles. If those attitudes are lost, regaining them can be extremely difficult.

We really have two tax systems running simultaneously, from the tax administration point of view. We have a system that works automatically, with wages and withholding and standard deductions. People who have very little option—who pay their taxes. Then we have the other system where people do have options, where they are itemizing deductions, where their income is from small businesses and things like that.

The first system, which is the heart of the tax system, works almost with no human hands touching it—and it may work because human hands don't touch it.

The second part of the system, which is what might be called the voluntary compliance part, is not working well at all. Compliance is very low in those areas. Audit coverage is very low, and that part of the system is not working well.

Mr. DORGAN. Unlikely as it might be, if either of the three of you were tapped this afternoon to be the new Internal Revenue Service Commissioner—

Mr. KURTZ. That is more unlikely than you think it is.

Mr. DORGAN. And you were called in and asked what do we need to do at this point—clearly we have problems—in short order, what do we have to do? What is the major recommendation you would make in response to a question like that, as the new Internal Revenue Service Commissioner?

Mr. COHEN. One of the things that we haven't addressed is the Government employees' morale, not just Internal Revenue Service employees' morale but all Government employees' morale. You don't find good young people coming out of college today who want to go into Government service because it has been trashed by two consecutive Presidents. When the President of the United States gets up and says these are terrible people, who wants to work with them? The president of General Motors would get up and say—if he was trying to get his people to work better, "you make good cars, you could make them better if you try harder." He would never say you make lousy cars. Two Presidents have year after year been saying you make lousy cars, and they have lumped all Government employees in the same category. So that is one of the problems.

The second problem was alluded to by Mr. Owens. If you are a brandnew employee, you are making less than the promised wage. If you are a brandnew employee you sit there and you say, Gramm-

Rudman will take its second bite next October, is my job on the line. If it is and I have got an alternative job over in private industry, why should I take the Government job even though I might enjoy the Government service. Why should I take the Government job and run the risk of next October going out looking for another job? Even if it is not going to happen, each of those employees worries about it. Because I was a Government employee in 1952 when there was a RIF and I worried about it although nothing happened to me.

Those two things are affecting morale governmentwide and the Internal Revenue Service is no different.

The Internal Revenue Service happens to have a vital task, doing interesting work at the forefront of the accounting and legal profession. They get good people for that reason, but they are not getting them as good as they used to.

Mr. DORGAN. I don't minimize. Incidentally, I share your view about morale and its cost, but I guess I am asking is if you are the new Internal Revenue Service Commissioner and you sit down with the President or the Treasury Secretary this afternoon and he says, look, we all know we have got a serious problem, so what do we do? You say we do what?

Mr. COHEN. I would ask Mr. Owens today what is your maximum absorption rate for personnel. He didn't answer that question. It wasn't asked of him.

Mr. DORGAN. Mr. Alexander.

Mr. ALEXANDER. Well, that question has been answered. Mr. Egger answered it last year, you have it in last year's record, pages 216, 217 on the absorption of personnel. Since we have that in the record, I think you can use that as this year's answer as well.

Thank goodness I am not going to be the new Commissioner. You are going to get a very fine new Commissioner if the reports in the papers are true, who has had prior Government service, who knows the Internal Revenue Service, who is a very bright tax lawyer, and also a very fine administrator, who knows how to restore the morale of and organize that important agency. Though I think that is what you may find, one problem is—

Chairman PICKLE. Who are you talking about?

Mr. ALEXANDER. I am not identifying anyone. I am not in a position to—

Chairman PICKLE. You certainly have drawn a very clear picture of this individual.

Mr. ALEXANDER. I have mentioned in the paper. All I know is what I read in the papers. There are several mentioned, one more recently, a very outstanding individual. I notice a couple of names came from Texas, which does show good judgment, does it not, Mr. Chairman, on the part of the administration?

Chairman PICKLE. You are making more sense the further you go, Mr. Alexander.

Mr. ALEXANDER. So I better not go any further. I always had a problem with this. It is clear that I still have the problem. Some people never learn.

You do have two problems. One is a lack of resources, the other is probably declining morale. That needs no further discussion. The new Commissioner is going to have an extremely difficult job in

preventing further erosion of our already eroded Federal tax system, and in restoring the tax administration system to the health that it should have. But he is going to need help from this subcommittee, the Ways and Means Committee, the Finance Committee and the Appropriations and Budget Committees to do that job.

Mr. KURTZ. I would second that. It needs more people, and I might say I think the morale will go up, it would go up substantially if the Agency were viewed as really addressing its problems or adding people or behaving a little more efficiently, people would again be proud to work for the service. And I think there are other problems Sheldon mentioned, which are serious, of Government pay scales compared to private industry in certain of the technical fields. I agree with all of that.

Notwithstanding that, the single most important thing I think would be a program to expand the size of the Internal Revenue Service. I assume that the people in charge will spend that money wisely.

Mr. DORGAN. Mr. Chairman?

Chairman PICKLE. Mr. Guarini.

Mr. GUARINI. Thank you.

Good to see you again.

I imagine the problem we have is getting stability in our budget. That has to be part of every planning for a long range strategy. The year to year swings in the budget certainly don't lend itself to getting that stability.

You mentioned on the trust fund. Would either of you gentlemen want to expound on that? Do you think the trust fund would give us that stability that we need and should that be the way to go in your opinion?

Mr. ALEXANDER. I would like to respond to that, Mr. Guarini, but all I have seen on this, of course, is what the Senate Finance Committee handed out.

Mr. GUARINI. Conceptually?

Mr. ALEXANDER. I understand a much more detailed paper is coming out today. It provides two things:

One, an increase in resources, and two, stability in resources. It provides for Internal Revenue Service to have \$6.1 billion in 1987, rising to \$6.4 billion in 1991, rising in steady, small increments. That makes a great deal of sense. That would permit stability, that would permit long range planning, that would solve the problem of the layoffs that we have been discussing, and the ups and downs which are a concern to you and brought about your question.

Mr. GUARINI. Do your colleagues share that view?

Mr. COHEN. The budget that is submitted to the Office of Management and Budget each year is usually in 3 or 5 year estimates, and they show projected needs as of that point. Now, it is difficult to be precise about your needs more than a year or two ahead, so the third and fourth year slice is a guess, but nevertheless, the management of the Internal Revenue Service can project that pretty well in advance.

You need the commitment of someone, whether it be by way of trust funds or the President—I worry about whether the Appropriations Committees on both sides of the Hill might like the trust

fund idea. I would. I would endorse Don's endorsement of that proposal.

Mr. GUARINI. At least have long—

Mr. COHEN. Long range projects in which there is a target 3 or 4 or 5 years out and we work toward that target.

Mr. GUARINI. Jerry?

Mr. KURTZ. I agree. I think if you look at the budgets by categories over the years—actual resources consumed over the years—what you find, apart from the fact that the totals are not adequate, are swings from one function to another. That is, the service goes along, for example, with cuts in the collection function each year until suddenly the inventories are completely unmanageable. Then, it will pull 5,000 positions out of other things and put them into collection for that year and then begin the cuts again.

This is not poor management on the Service's part. The problem is that with uncertain budgets, uncertain appropriations, hiring freezes which come and go notwithstanding the size of the appropriations, it has become impossible to plan. So I think it would be a great, great improvement for the Internal Revenue Service to have longer term budgets.

Mr. DORGAN. Mr. Cohen has to leave to testify at the Select Revenue Committee.

Thank you for your testimony.

Mr. GUARINI. Would you state whether or not, knowing the great increase we have of tax forms, growing population, complexity of business and forms and everything that is happening, whether or not you think that the way we do business for the Internal Revenue Service should change, that there should be some new, creative ideas of how we go about tax collection, that perhaps the Internal Revenue Service itself has become unmanageable. The way it does business today, do you think it has become unmanageable?

Mr. KURTZ. No. I think there are very substantial problems, but I don't think it has become unmanageable. I think that while there is room for technological improvement of all kinds—computer equipment, automated telephone equipment, and information processing equipment—there is no substitute for face to face examination of a taxpayer. I think that is the cornerstone of the system that we have today, and I think it would be a mistake to think that machines can replace that. Machines can supplement certain aspects of that, but for the small businessman, the high income taxpayer with a lot of deductions, there is no substitute for a detailed face to face consideration.

There is no substitute for collecting debts from deadbeats for going out and knocking on the door. You can send notices to some extent and the Internal Revenue Service has made enormous improvement in that part of the process. In the end, there is a certain hard core you have to go out and knock on the door and get the money.

Yes, there is room for technological improvement, but it will not substitute for what I view as the core activities of the Service.

Mr. GUARINI. You may have noticed that the committee has been known to change the tax laws very frequently, and we have had ERTA and TEFRA and DEFRA and now total tax reform, all within the last 5 years and next year will be technical corrections.

The business world has been thrown, I am sure, into confusion, to say nothing at least of the tax lawyers. But has that caused an additional impact upon the administration of tax law?

Mr. KURTZ. Yes, sir; I have noticed those changes even as a practitioner, but yes, it is a very, very serious problem.

Mr. GUARINI. Does it have an effect on Internal Revenue Service and their administration as a result of these massive changes that we have been swinging back and forth with the laws, to say nothing of the budgets?

Mr. KURTZ. Yes, sir; in two respects. One is simply that change adds a great deal of additional burden to the service. People have to be trained, regulations have to be written, computers to be re-programmed. So it is an additional workload.

Moreover, in my view, the tax law in many areas is so complicated that I do not believe the Internal Revenue Service has the ability to hire a sufficient number of people capable of administering it at the more sophisticated levels.

Mr. ALEXANDER. I certainly agree that complexity and change have created and continue to create great problems for the Service, as well as for taxpayers and tax practitioners.

Mr. GUARINI. Would it be great if we could have a moratorium for 5 years on tax law changes?

Mr. ALEXANDER. It certainly would, but right now you have H.R. 3838 having passed the House; you will soon have the Senate Finance Committee version. You do have a chance to have some basic simplification in the law. Then, of course, you are going to need a 1,400 page technical correction act. After that, how about a moratorium?

Mr. GUARINI. We will have technical corrections that will probably be more vast than even the Tax Code.

Mr. ALEXANDER. It will be. H.R. 3838 is 1,379 pages long. I visualize technical corrections only a few pages longer.

Mr. GUARINI. Let me ask your opinion on a fact—I understand they want to take 6 million people off the tax rolls. It would be unnecessary for them to file a tax return. Is this salutary, in your opinion? Would it be wise to keep them on the computer where they would file a simple form, just in case they do go into a taxable bracket in subsequent years, to have them file a simple statement that my return is under a certain margin?

Mr. ALEXANDER. I don't know whether the benefit of that would be worth the burden. If I were back in the Service, I would of course do what a good bureaucrat does, that is appoint a task force to report within 6 months.

Mr. GUARINI. What is your gut reaction?

Mr. ALEXANDER. My gut reaction is the benefit is not worth the burden. Those are already on the Social Security rolls now, and I am not sure that any substitute for the 1040EZ would be worth it. Some of the people wouldn't be on the Social Security rolls but those I don't think would be worth having on the tax rolls.

Mr. KURTZ. I don't see any point in putting them in. Basically when these people move over to the tax-paying threshold in those income brackets they tend to be employees subject to withholding, so that, by and large, the taxes get collected at the employer level. In fact, in the Service's programs to uncover nonfilers, there is

very little net revenue gained because a very large percentage of nonfilers have had withholding and have paid the taxes.

Chairman PICKLE. Well, I thank you, gentlemen, for your testimony. Perhaps more than anyone in America you can give this committee some extremely valuable and needed information.

Having listened to all three of you, it seems to me that you point out, with grave misgivings, the status of the Internal Revenue Service system now. Mr. Cohen pointed out that today there are approximately 1,000 more employees in the examination field than when he was Commissioner 17 years ago. On the surface it would look like we are terribly understaffed in this area. He makes the statement that it is obvious that the supplemental appropriation has been badly mishandled. We have a catastrophe facing us if the supplemental isn't approved almost immediately.

Mr. Alexander, you point out several areas of shortcomings. Namely, that the appropriations actually fall short of achieving the goals. You question whether Gramm-Rudman really ought to be applied to the Internal Revenue Service under the budget. We are asked over and over again—should the Internal Revenue Service be exempt? You point out the EP&EO organization has been cut, that collection resources have been reduced, and that there has been a substantial decrease in the number of Internal Revenue Service rulings.

And Mr. Kurtz, you point out clearly many of these same things, saying again that the supplemental has been terribly mishandled, but observing that it does us little good to go back and point the finger of blame and ask ourselves what are we to do in the future? How do we prevent this? Can something be done about it?

What I would like to do is to ask you gentlemen what advice, what suggestion, do you give this committee? You have pointed out some of the things you think are shortcomings. We can work on those individually. Overall, what should the committee ask the Congress to do that would restore the confidence of the American people in the Internal Revenue Service system?

Mr. ALEXANDER. Mr. Chairman, you have asked Acting Commissioner Owens for some material today, I believe, which would give you the information you need to make recommendations to correct the shortcomings that we have pointed out in the 1987 budget request. Whatever the fault, the 1986 supplemental really must be appropriated.

As to the 1987, the material that you will obtain as to the absorption rates and as to utilization of additional resources would give you a sound basis for recommending correction of these deficiencies. I would hope that the Ways and Means Committee would study the Senate initiative very carefully, the one that has been previously discussed before you, to see whether that might be a better long range permanent solution to the recurring problems of Internal Revenue Service.

Mr. KURTZ. I agree with what Don said. Basically it seems to me what the committee should have from Internal Revenue Service is a plan which goes out 3 or 4 years. The plan should show what degree of service certain appropriations would produce. That is, if the ideal in correspondence would be a backlog of let's say 100,000 instead of a million, what would it take to get there, so that the

committee would know at each stage what the appropriation will produce. Not how many letters will be answered, but how far off the appropriation is from what would be considered a reasonable mark.

The other important thing is somehow to provide stability. The Senate Finance Committee bill should be designed to provide longer run stability so that the appropriations of the Internal Revenue Service don't get bounced around from year to year, causing a crisis here 1 year and a crisis there the next year.

Chairman PICKLE. I want to deviate from my question to ask Mr. Persky, Tom Persky—sitting out in the audience—I believe he is the representative of the Acting Commissioner, if he would come up. I want you to submit to this committee—the Internal Revenue Service—to submit to the subcommittee, on June 1, and every month thereafter until the end of this fiscal year—July and August—the status of your inventory. That is, the status of the accounts receivable and uncollectables, correspondence, unpostables, the other categories that I asked for. I want to know how we are coming month by month between now and the end of the fiscal year. Will you submit that?

Mr. PERSKY. Yes, sir; I would be very happy to. We produce those figures, basically, on a weekly basis and providing them to you would be very easy for us to do.

Chairman PICKLE. Then this being May 12, we will expect one in by June 1 and each month thereafter, so we will have some idea.

Also, we would like for you to be able to give this committee the analysis I asked for this morning, of what you would do if you had extra funding in the categories of numbers, if you had a 200, 400, 600, or 1,000 additional employees, where would you put them, what services would they perform?

Mr. PERSKY. We have made a preliminary cut at this kind of allocation and I believe it is attached to the testimony. So, we have an initial view of where we would put those additional resources.

Chairman PICKLE. Well, do we have that information?

All right, we will be anxious to see that.

Mr. Kurtz, I believe it was you who asked these questions. At the end of your testimony, you said we should know how many tax returns should be examined; what are the manageable appeals, inventory and Tax Court backlogs; what would it take to be able to answer most correspondence and telephone calls promptly and accurately. You are saying until we have that information, you really don't know what kind of budget to really ask for.

Mr. KURTZ. You don't know how far short, what you are not providing for. I just used those as illustrations of the kind of the measures that I think the committee should have. What I am suggesting is that you need an ideal in order to know how far along that road a particular appropriation will go. That is, it is less meaningful to say, for example, that we have answered 44 million phone calls over the year, than it is to know how many have not been answered.

So the committee can judge whether in its judgment money should be spent to improve that. The judgment may be made that it is OK where we are today, but unless you know what the money

buys, in effect, how close it gets you to the ideal, it is very hard to make those judgments.

Chairman PICKLE. Mr. Persky, could we be told how many calls have not been answered?

Mr. PERSKY. We do have statistics on the Taxpayer Service call system and what we have done. It is very difficult to identify exactly how many calls haven't been answered, because one of the things that happens is that people will call, if they don't get in the first time, they will call back. Ultimately, if they are persistent, they get in. This year, we were very successful in answering calls on the first time. There are some people who will never get in. It is very difficult for us to measure exactly what that number is. But we have seen tremendous improvement this year in the number of people getting in the first time and the second time.

Chairman PICKLE. I think it is interesting that the Commissioners would come back, not in any negative sense, but in an objective manner, and point out that what I guess we all must admit, that morale in Internal Revenue Service is rather low, particularly based on the 1985 experience. The Internal Revenue Service has not handled the supplemental well at all, and now we are faced with a great catastrophe. Most importantly, we need to have a better system for our plans and for a program that has to be put into effect.

Are you gentlemen concerned about the low rate of compliance—that is, the falling rate of compliance?

Mr. ALEXANDER. Yes; we certainly are.

Mr. KURTZ. Yes; certainly.

Mr. ALEXANDER. With more than \$100 billion that should be collected in taxes not being collected, no wonder we have got an enormous budget deficit. Look what \$100 billion a year could do. Look what \$50 billion would do toward reducing the deficit. Fifty might be attainable, the \$100 is clearly not.

Chairman PICKLE. Well, I thank the gentleman. You don't have any other questions?

Mr. Dorgan.

Mr. Guarini.

Mr. GUARINI. You said, Don, \$140 billion is not being collected in your statement.

Mr. ALEXANDER. I said a little better over \$100. I believe that Congressman Dorgan had a slightly higher figure than the figure I had. If one assumes about an 80-percent compliance rate, which might be slightly low, and extrapolate from Internal Revenue Service' proposed collection, we would have higher than \$100 billion. We won't have the magic \$200 because the 80-percent rate should not be applied to the entire universe that Internal Revenue Service is predicting next year.

Chairman PICKLE. We have only collected \$340, \$334.5 billion, last year from individual income taxes, I understand, and this sum of money would be virtually one-third of what we collect from the individual returns. That is an enormous sum of money.

Mr. ALEXANDER. But a number of other elements are includable as well as individual taxes. Excise taxes, corporate income taxes, and the like, which are not insubstantial.

A large component, I think my cohort, Jerry Kurtz, has a bunch of graphs that I don't have—

Chairman PICKLE. It is still a large high and shouldn't be.

Mr. ALEXANDER. A large component is Social Security taxes and there you find compliance considerably higher.

Chairman PICKLE. You should.

Mr. KURTZ. These are charts from Johnny Finch.

Chairman PICKLE. I have seen those charts. Let me ask you, as a result of the budget starvation and insufficient funds, does this give rise to an undesirable, pernicious practice of having quotas on auditing? This is where consciously or subconsciously the auditor feels he has to go back to a supervisor and say, I have extracted this much from an individual, therefore making it an unfair audit.

Mr. ALEXANDER. Sure, there is a perception and a reality. The perception is greater than the reality but I was somewhat disappointed to see that a practice that we had back when I was with Internal Revenue Service seems to have been largely dropped, and that is of not making exact predictions—with this we will collect blank billion dollars.

If the system worked perfectly, which of course it never will, examination would collect nothing. An exact prediction of a universe tends to find itself reflected in an exact prediction of the components of that universe and the prediction may become a goal, which in turn is remarkably like a quota.

We used to say, based on past experience, the additional resources will probably produce blank, and make no absolute prediction that additional resources are going to produce additional money. That sounds like a quota system.

Chairman PICKLE. The examiner is concerned about his job, the job of determining tax liability. Knowing the personnel problems that you have had because of budgetary constraints, is there a conscious program or a subconscious program regarding quotas, or do you feel that a quota system doesn't exist at all?

Mr. ALEXANDER. I don't believe that there is a quota system now. I don't believe there was a quota system back then. There is undoubtedly in this imperfect world some pressure on the examiner to stop producing no change reports, particularly when there is such emphasis, as you heard this morning, upon the decline in the no change percentage.

Chairman PICKLE. Mr. Persky, what is the status in the Internal Revenue Service today regarding quotas? Is there any memorandum as to how quotas should be handled? Do we have as a department, quotas for auditing to obtain so much money from the examination process?

Mr. PERSKY. I can say unequivocally there is no quota system, and I can say that revenue agents and their managers are not given revenue targets to produce. But again, there is a perception and a reality. I think that the reality is, if you had a revenue agent who in a year's time in 100 examinations never produced a dollar of revenue, you would want to know if that revenue agent was doing a good job. So as a consequence, we take the view that these figures are helpful in evaluating and training revenue agents. But they are not a quota system.

Chairman PICKLE. Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman.

I see while I have been gone to testify before the other committee that Mr. Cohen has left. I wanted to ask him about the statement he made about professional deadbeats. I guess I could be accused of being a little naive. I hadn't thought of that before. Are there, former Commissioners, in your opinion, are there people who really game the system and if there are certain standards or certain levels, try to operate right up to those levels to avoid compliance?

Mr. KURTZ. I was never aware of it. My own experience is that it was not a problem. It did not seem to make a significant difference. From time to time when thresholds were changed because of the resources or inventories or whatever the amount right up at that level did not increase. I never saw that.

Mr. ALEXANDER. On a scale of Internal Revenue Service problems 1 to 100, I would put that, with 1 being the bottom, I would put that at 1.2.

Mr. KURTZ. The more important aspect is that where inventories run very high, and there are inadequate resources, inevitably thresholds do rise, and there are more and more delinquent accounts to which the service does not, and cannot with existing resources, pay attention.

Mr. SCHULZE. That is understandable. I wonder whether this was a big, large business in gaming or playing?

Mr. KURTZ. I might say there is a related issue that bears on this which no one has mentioned. That is, calling on the service to do nontax related functions. For example, collecting debts. I think that is a terrible idea and just beleaguers an already greatly beleaguered Internal Revenue Service. I do think there will be game playing in that area, that is, if a taxpayer has his refund seized to pay off part of a student loan, he will make sure that the next year he does not have a refund. He will then become a collection problem for the Internal Revenue Service as well as a collection problem for the Small Business Administration, or Veterans' Administration, or whatever. I think it is a very bad idea, and it consumes resources which the Internal Revenue Service does not have, and tarnishing the image of the Internal Revenue Service. It is hard enough to go through life being a tax collector, let alone being a general debt collector.

Mr. SCHULZE. Chairman Pickle and I talked informally on the idea of multiyear budget. Give me our thoughts on that.

Mr. ALEXANDER. I like it. I think it would be a highly advisable thing, but of course, I am not around the shop any more.

Mr. SCHULZE. It seems to me to be one of the solutions that might be difficult to convince everybody else of and that it might be a long time coming. It also seems to me that it could be one of the ways to iron out the process a little bit.

Jerry, do you agree?

Mr. KURTZ. I agree 100 percent. If that were the only thing that comes out of these hearings—multiyear budgeting—I would consider the hearing a triumph.

Mr. ALEXANDER. So would I.

Mr. SCHULZE. Thank you.

Chairman PICKLE. Well, let me add this to it. Whether it is multi-year or whatever approach we take, as one member of this committee, I serve notice that our patience is running short and the American people's patience is running short on the constant inadequacies of the funding and performance of the Internal Revenue Service. We have gone to many of these service centers and seen them firsthand. Individually, I think they are doing a good job. They are trying, they are working hard, and yet performance a year ago was not satisfactory. We have to admit that.

We need some kind of machinery to require the Internal Revenue Service to give us a plan on a 1-, 2-, or 3-year basis, justify what that plan is and stay with the program, and not let the Office of Management and Budget just squeeze you down to a point where you cannot have productivity.

All politics aside, if we don't do that, it seems to me the confidence of the American people is going to be severely shaken. Our system will be in deep trouble, because we rely totally on voluntary compliance. I don't think we have any more important problem facing the Government than to require a good plan on a 1-, 2-, or 3-year basis, at least, and to see that that program is put into effect and not tampered with, or that we be hesitant to request what was obviously needed.

It seems to me like we have to face that. If we don't have the muscle to put in some kind of a plan, we are going to be faced with a crisis year after year. I am tired of that. I think the public is tired of it.

Mr. SCHULZE. Thank you, Mr. Chairman.

Chairman PICKLE. Mr. Dorgan.

Mr. DORGAN. Thank you, Mr. Chairman.

Well, thank you, Mr. Alexander, Mr. Kurtz, Mr. Persky. Thank you very much.

The next panel we are going to hear from is Mr. Finch from the U.S. General Accounting Office; Mr. Tobias, president of the National Treasury Employees Union; Hugh Calkins, Esq., chairman, Section of Taxation, American Bar Association; and Albert B. Ellentuck, chairman, executive committee, Tax Division, American Institute of Certified Accountants.

Would you gentlemen come forward.

Chairman PICKLE. Our panel consists now of Johnny C. Finch, Senior Associate Director of the GAO Office. Mr. Finch is over to my right. Then we have Mr. Robert M. Tobias, president of the National Treasury Employees Union. Mr. Tobias, then Mr. Hugh Calkins, Esq., chairman of the Section of Taxation, American Bar Association; and then Mr. Albert Ellentuck, chairman of the executive committee of the Tax Division of the American Institute of CPA's.

Mr. Finch, if you would proceed first.

Do each of you have written statements? All of your statements will be included in the record.

STATEMENT OF JOHNNY C. FINCH, SENIOR ASSOCIATE DIRECTOR, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Mr. FINCH. Thank you, Mr. Chairman.

I do have a detailed statement, and with your permission, which I think you just gave me, sir, I will submit that and try to briefly summarize it. Basically I want to emphasize several points that I think the subcommittee should consider in evaluating the Internal Revenue Service's request for additional resources. I will try to be brief.

First, we believe that the funding increases called for by the 1986 supplemental and the 1987 budget request are warranted. That opinion is based on a consideration of such factors as the IRS basic mission of fairly and equitably administering the tax laws and collecting taxes due the Government, the level of resources now available to the IRS to accomplish that mission, the extent of noncompliance with the tax laws, and the growing taxpayer population.

Second, we believe that the amounts specifically requested for the returns processing and collection activities may be insufficient to cope with their workloads. The budget request for 1987 assumes that the IRS service centers will have fully recovered from the problems they experienced last year in maintaining manageable inventory levels. The evidence available at the time we prepared this statement, however, calls the IRS assumption into question.

As for collections, neither the 1986 supplemental nor the 1987 budget request provides additional resources to deal with an accounts receivable inventory that, according to the IRS records, rose dramatically in 1985.

Third, the Congress is presently forced to make resource decisions on an activity by activity basis because the IRS management information system does not provide the kind of marginal yield data needed to determine where additional resources would best be allocated or whether existing allocations provide for the best use of the IRS resources. Because of that limitation in the IRS data, we cannot tell you where additional resources should be applied in the Internal Revenue Service to yield the best results. This is a point that you gentlemen have raised consistently throughout the morning.

For example, accounts receivable is not the only inventory in the IRS that needs attention. There are various service center inventories, as mentioned earlier, and inventories in appeals and tax litigation that are expected to continue to rise even after applying the additional resources called for in the 1987 budget request.

Fourth, mindful of the limitations in the IRS data, we recognize, nonetheless, that the Congress needs to make budget decisions based on the best information available. With that in mind, we believe additional returns processing resources would be justified to the extent they help foster improved taxpayer relations through a reduction in inventories of taxpayer correspondence, unpostable transactions, and the like.

We believe, also, that the IRS reported average yield/cost ratio of about 19 to 1 in the accounts receivable area and the significant growth in the accounts receivable inventory indicate that addition-

al collection resources would provide a favorable return on the dollar.

Fifth, it is particularly important, Mr. Chairman, that the Congress act immediately on the supplemental request for 1986. In attempting to avoid a recurrence of the processing problems that it encountered last year and thus improve public confidence in the tax system, the IRS has already increased its return processing and taxpayer assistance staff levels as provided for in the supplemental request.

According to the Secretary of the Treasury and according to Mr. Owens' testimony this morning, if the supplemental is not approved, the IRS will be forced to furlough employees and take other measures that will lead in total to an estimated revenue loss of about \$3.5 billion.

Chairman PICKLE. How much?

Mr. FINCH. \$3.5 billion in fiscal years 1986 and 1987.

Sixth, because workloads in various IRS activities are interrelated, funding Internal Revenue Service examination initiatives for fiscal year 1987, primarily the revenue initiatives, which Mr. Owens discussed, will probably have a ripple effect on other Internal Revenue Service functions such as collections and appeals. That ripple effect will cause workloads in other areas to increase, which will probably generate IRS requests for additional resources in fiscal year 1986 and beyond.

Seventh, the IRS unique role should be recognized. The IRS stands virtually alone on the revenue side of the Government. Governmentwide reductions applied to the IRS will likely result in foregone revenues, thus increasing the deficit. Providing the IRS with additional resources will have the opposite effect. While the tax system collected about \$743 billion in revenue in fiscal year 1985, the IRS budget for 1985 was \$3.6 billion. Thus, the IRS administration of our tax system cost about 48 cents for each \$100 collected. It seems like a fairly reasonable investment.

Eighth, it is important to keep in mind that the IRS various activities do no more than require citizens to pay those taxes that were properly due in the first place, and that were promptly paid by most of their number. Thus effective compliance should not be viewed as representing a special burden on the public; rather it is aimed at ensuring that all pay their fair share.

That concludes my statement, Mr. Chairman.

[The statement of Mr. Finch follows:]

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY
EXPECTED AT 9:00 A.M., EDT
MONDAY, MAY 12, 1986

STATEMENT OF
JOHNNY C. PINCH, SENIOR ASSOCIATE DIRECTOR
GENERAL GOVERNMENT DIVISION
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
OF THE HOUSE COMMITTEE ON WAYS AND MEANS
ON THE ADMINISTRATION'S FISCAL YEAR 1987 BUDGET REQUEST
FOR THE
INTERNAL REVENUE SERVICE

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to assist your Subcommittee in considering the Administration's fiscal year 1987 budget request for the Internal Revenue Service (IRS). Our testimony is based primarily on the experience we have gained from conducting audits of tax administration operations and activities over the past several years.

In discussing the proposed budget for fiscal year 1987, we will also address the fiscal year 1986 supplemental appropriation request now awaiting congressional action. That supplemental calls for increasing IRS' staffing by 6,950 average positions and increasing its funding by \$340 million, about \$157 million of which is to offset reductions occasioned by the Gramm-Rudman-Hollings Act. The fiscal year 1987 budget request builds on the 1986 supplemental by seeking to further increase IRS' staffing by 1,360 average positions (to a total of 95,084 average positions) and its funding by about \$272 million (to a total of about \$4.1 billion). Together, the supplemental appropriation and the 1987 budget request provide for a 10-percent increase in the staffing level and a 12-percent increase in the funding level currently authorized by the Congress for fiscal year 1986.

In my testimony today, Mr. Chairman, I want to emphasize four points that this Subcommittee should consider in evaluating IRS' request for additional resources.

--First, we believe that the funding increases called for by the 1986 supplemental and the 1987 budget request are warranted. That opinion is based on a consideration of such factors as IRS' basic mission of fairly and equitably administering the tax laws and collecting taxes due the government, the level of resources now available to IRS to accomplish that mission, the extent of noncompliance with the tax laws, and the growing taxpayer population.

--Second, we believe that the amounts specifically requested for the returns processing and collection activities may be insufficient to cope with their workloads. The budget request for 1987 assumes that IRS' service centers will have fully recovered from the problems they experienced last year in maintaining manageable inventory levels. The evidence available at the time we prepared this statement, however, calls IRS' assumption into question. As for collections, neither the 1986 supplemental nor the 1987 budget request provides additional resources to deal with an accounts receivable inventory that, according to IRS' records, rose dramatically in 1985.

--Third, the Congress is presently forced to make resource decisions on an activity by activity basis because IRS' management information system does not provide the kind of marginal yield data needed to determine where additional resources would best be allocated or whether existing allocations provide for the best use of IRS' resources. Because of that limitation in IRS' data, we cannot tell you where additional resources should be applied in IRS to yield the best results. For example, accounts receivable is not the only inventory in IRS that needs attention. There are various service center inventories, as mentioned earlier, and inventories in appeals and tax litigation that are expected to continue to rise even after applying the additional resources called for in the 1987 budget request.

--Fourth, mindful of the limitations in IRS' data, we recognize, nonetheless, that the Congress needs to make budget decisions based on the best information available. With that in mind, we believe additional returns processing resources would be justified to the extent they help foster improved taxpayer relations through a reduction in inventories of taxpayer correspondence, unpostable transactions, and the like. We believe, also, that IRS' reported average yield/cost ratio of about 19 to 1 in the accounts receivable area and the significant growth in the accounts receivable inventory indicate that additional collection resources would provide a favorable return on the dollar.

Before going into more detail on the proposed budget for 1987 and its impact on specific IRS activities, a short preface about noncompliance and other factors that affect IRS' workload might prove useful.

NONCOMPLIANCE

Our tax system provides about 90 percent of the revenues for financing the government's programs and activities. As such, the federal government's financial well-being depends, in large measure, on whether people are willing and able to comply with the tax laws.

IRS research, however, points to a significant level of noncompliance with those laws. IRS has estimated, for example, that the noncompliance rate in 1981 was 19.3 percent and that the tax gap--taxes owed but not paid--was \$81.5 billion. For fiscal year 1987, IRS has projected a noncompliance rate of 18.15 percent and a tax gap of \$100.5 billion.

A detailed survey conducted in 1984 by Yankelovich, Skelly and White, Inc., attempted to determine why people do not comply. The study showed that almost 20 percent of the sampled population admitted to cheating in preparing their federal income tax returns and that about 33 percent strongly endorsed cheating. The study also found that personal definitions of

honesty and the perception that most people cheat were the most significant reasons why people did not comply.

FACTORS AFFECTING IRS' WORKLOAD

Any assessment of IRS' budget has to take into account the workload facing IRS and the fact that IRS' workload has been growing steadily over the years. I will be citing various workload statistics later in my statement as they relate to specific IRS functions. There are two factors, however, that affect IRS' workload across-the-board but over which IRS has little, if any, control. Those factors are (1) a continuing growth in the size of the taxpaying public as evidenced by the increase in filed tax returns and (2) tax law complexity.

The number of tax returns filed has increased

Over the past several years, IRS has had to process a steadily growing number of tax returns without an appropriate increase in resources. For example, IRS statistics indicate that taxpayers filed about 170 million tax returns in 1985--a 38-percent increase since 1976, when taxpayers filed 123 million returns. At the same time, IRS' staff years increased from 84,300 in fiscal year 1976 to 92,259 in fiscal year 1985--an increase of about 9 percent. Although IRS has attempted to improve productivity through such things as an increased use of computers, those steps have not been sufficient to enable IRS to effectively cope with its increased workload given the staff available.

Tax law complexity

Frequent changes to the Internal Revenue Code have produced tax provisions that are increasingly difficult for taxpayers to understand and IRS to administer. Such changes often make examinations more difficult; generate more controversies between IRS and taxpayers; and require IRS to revise or extend its guidance to taxpayers through regulations, publications, and tax forms. For example, the Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982 and the Deficit Reduction Act of 1984 have resulted in the need to amend or create 250 regulations.

The impact of complexity can also be seen in the fact that a growing number of individual taxpayers are filing the long form 1040 despite efforts to create a simpler tax form, the 1040EZ, and to make the shorter 1040A usable by more taxpayers. IRS estimates that 64 percent of the individual taxpayers will file a Form 1040 in 1986--up from 60 percent in 1982. Moreover, IRS estimates that the number of 1040As and 1040EZs filed this year will decrease by 9 percent and 3 percent, respectively, from the number filed last year. Increasing use of the long form adversely affects IRS' workload because these forms take longer to process and audit.

IMPACT OF BUDGET REQUEST ON MAJOR IRS ACTIVITIES

The 1986 supplemental appropriation and the budget request for 1987, when considered together, provide for substantial increases in IRS' examination, returns processing, taxpayer service, and appeals/tax litigation activities. We believe each of those increases is warranted. We believe also, however, that the staffing level requested for returns processing in fiscal year 1987 may be insufficient considering the current status of service center inventory levels.

The 1986 supplemental and 1987 budget request provide for virtually no change in staffing levels in IRS' collection function. Considering the status of IRS' inventory of accounts

receivable, it seems reasonable to assume that the infusion of additional resources into the collection function would prove beneficial. Because of limitations in IRS' management information, however, we do not know whether additional resources, if available to IRS, would provide even greater benefits if applied to some function other than collections.

Examination activities

Examination is IRS' primary program for determining whether taxpayers have correctly determined their tax liabilities. To do this, IRS examines taxpayers' books and records to verify reported income and deductions, uncover unreported income, and validate exemptions and credits. In fiscal year 1985, IRS examinations resulted in assessments of \$17.7 billion.

The fiscal year 1987 budget request for examination provides for a net increase of 2,562 average positions. This increase reflects the Administration's decision to support two specific enforcement initiatives affecting IRS' examination activity--a revenue initiative and a document matching initiative. This increase is significant in that, if approved, IRS estimates that audit coverage will go up slightly--reversing a downward trend over the past 10 years. In addition, the increase should improve IRS' ability to deal with special compliance problems, such as those posed by abusive tax shelters and tax havens.

The revenue initiative calls for an increase of 2,500 average positions in each of the next 3 years, beginning in fiscal year 1987. According to IRS budget estimates, this initiative is expected to increase collected revenue by \$4.7 billion through fiscal year 1989 and \$10.3 billion through fiscal year 1991. For fiscal year 1987, IRS estimates that as a result of this initiative, it will examine an additional 120,000 tax returns, which will result in assessments of \$829 million. As we have testified on other occasions, we believe this initiative would be money well spent because it would increase revenues due the government and increase IRS' examination presence.

For the document matching initiative, the Administration proposes an increase of 135 average positions in Examination to follow up on underreported income cases generated by the document matching program. IRS' budget estimates indicate that these additional positions will enable IRS to increase assessments by \$37 million in fiscal year 1987, raising the total number of assessments generated by the underreporter program to \$404 million.

If the 1987 budget request is approved, IRS expects to reverse the downward trend in audit coverage. IRS estimates that audit coverage will increase to 1.42 percent in 1987--up from 1.14 percent in 1986 but still significantly lower than it has been in the past. To provide some perspective, audit coverage was 2.59 percent in 1976 and 2.12 percent in 1980.

Although audit coverage has decreased since 1976, there is at least one significant difference between IRS' enforcement program in 1976 and its program today. IRS' document matching program in 1976 was not nearly as large as it is now. In fiscal year 1976, IRS was able to match about 157 million documents, or 35 percent of all documents received. In fiscal year 1985, by comparison, IRS was able to match about 541 million documents, or 78 percent of all documents received. Moreover, new tax laws, such as TEFRA, have expanded information and reporting requirements, as is the case with tips in the food and beverage industry. Because IRS' document matching program can identify potential underreporter cases that lead to eventual assessments, it could be argued that document matching plays a major role in

insuring compliance and offsets the adverse effect of decreasing audit coverage. In our view, however, nothing completely takes the place of increased audit coverage. Certain deductions, such as those for travel and entertainment expenses, can only be verified through an audit.

Returns processing activities

This is another area where the Administration is requesting a substantial increase in resources. In response to the returns processing problems IRS encountered last year, the supplemental appropriation request for 1986 proposes an additional 5,558 average positions so that tax returns and refunds can be processed in a timely manner. Specifically, IRS plans to use the additional resources to (1) restore production rates to those achieved in fiscal year 1984; (2) compensate for the decline in retention of experienced seasonal employees; (3) clear up backlogs in unpostables, adjustments, and taxpayer correspondence; and (4) improve the quality of operations. Considering last year's problems and the need to avoid a recurrence, we believe that the additional resources are warranted.

The 1986 supplemental also provides for an additional 255 average positions to process an expected increase in the volume of currency and cash transaction reports. These documents are used by various law enforcement agencies and are a key element in combatting organized crime and drug trafficking. The influx of these reports is the direct result of the Treasury Department's increased enforcement of Bank Secrecy Act provisions.

IRS' fiscal year 1987 budget request calls for a reduction of 1,590 average positions in the returns processing area. This decrease is the net result of (1) increases of about 1,100 average positions to staff the document matching initiative and to process additional tax returns and (2) a decrease of about 2,700 average positions that IRS considers nonrecurring costs. Those 2,700 positions are part of the increase proposed in the 1986 supplemental and are intended, for the most part, to reduce service center inventories to manageable levels. Because IRS expected to have those inventories at manageable levels by the start of fiscal year 1987, it did not include those resources in the 1987 budget. However, if IRS fails to bring its inventories under control by the end of this fiscal year, that decrease in staffing could prove damaging. IRS' statistics show that only three service centers had their unpostable inventories at manageable levels as of April 25, 1986, and only one service center had its adjustments/correspondence inventory at a manageable level.

Given the current status of those inventories, we question whether they will be at manageable levels by the end of this fiscal year. IRS' service centers have provided information to the National Office to the effect that existing resources are insufficient. The National Office has been reassessing the adequacy of its returns processing resources in light of that feedback. It remains to be seen whether that reassessment will cause IRS to propose a revision to its 1987 budget request.

For the document matching initiative as it relates to returns processing, IRS proposes an increase of 660 average positions in fiscal year 1987. At that level of resources, IRS expects to generate an additional 1.25 million contacts in fiscal year 1987 resulting in increased assessments of \$229 million.

Taxpayer service activities

Because our income tax laws are complex and not always clear, taxpayers often turn to IRS for help in preparing their tax returns. IRS provides much of that help through forms, instructions, and publications. In addition to making such documents available to taxpayers, IRS also answers tax law questions over the telephone, at walk-in offices, and through correspondence. During fiscal year 1985, according to IRS' statistics, IRS assisted taxpayers about 42 million times--an increase of 22 percent since 1980. Total taxpayer assistance activity also increased 17 percent--from 43 million contacts in 1980 to 50.3 million contacts in 1985.

In light of the problems it faced last year, IRS recognized the need to be as responsive to taxpayers as possible this year in order to assuage public concerns about our tax system. Its supplemental appropriation request for fiscal year 1986 calls for an increase of 670 average positions in the taxpayer service area and provides funds for the installation of 336 toll-free telephone circuits, an increase of about 11 percent. The budget request for 1987 calls for reducing that increased staffing level by 24 positions.

We have little doubt that those increased resources are necessary. Neither we nor IRS know, however, whether that will be enough. At the request of this Subcommittee, we have been checking on the accuracy and timeliness of IRS' telephone assisters in answering tax-related questions during the 1986 filing season. We are now analyzing the results of that work. That analysis should be useful in determining whether IRS' resources are now adequate to provide a sufficient level of service. Also, IRS plans, in mid-May, to reassess the adequacy of its taxpayer service staffing levels.

Appeals and tax litigation activities

The appeals and tax litigation activities are primarily responsible for handling cases involving taxpayers who disagree with IRS' examination results. The fiscal year 1987 budget request calls for an additional 497 average positions in those activities, an increase of 14 percent compared to the staffing level authorized for 1986. Of those positions, 465 are allocated to fund a tax shelter initiative. The purpose of this initiative is to provide resources to help appeals and tax litigation deal with the large number of tax shelter cases in their inventories and the additional cases they can expect to receive as a result of ongoing audits involving tax shelter issues. According to IRS' statistics, there were 412,278 returns with tax shelter issues in the examination process as of December 1985--137 percent more than the fiscal year 1980 inventory of about 174,000.

Under this initiative, IRS expects to close an additional 15,000 appeals and resolve over 11,000 additional cases in tax litigation. According to IRS, these closings should accelerate the collection of tax revenues by \$600 million in fiscal year 1987. Also, resolving a certain portion of these cases within IRS could lighten the Tax Court's workload. As of February 1986, the Tax Court had an inventory of 72,892 cases of which about 30,000 involved tax shelter issues.

IRS' budget estimates indicate that even with this tax shelter initiative, ending inventories in appeals and tax litigation are expected to rise dramatically. For example, the fiscal year 1987 ending inventory in appeals is expected to rise to 120,200 work units, an increase of 53,700 (or 81 percent) since 1985. Likewise, the ending inventory in tax litigation is expected to increase by 53 percent--from 82,200 in 1985 to 125,900 in 1987. Because much of the appeals/tax litigation

workload involves taxpayers who are contesting IRS' audit findings, it seems reasonable to expect further increases in that workload as a result of the additional audits that will be generated if IRS' revenue initiative is approved. In light of that, it would not be unreasonable to expect IRS to seek additional appeals and tax litigation resources in its budget requests for fiscal year 1988 and beyond.

Collection activities

Although IRS has made significant progress in automating its collection operation, it has not been able to keep up with the overall collections workload. According to IRS' statistics, the Service collected \$743 billion in fiscal year 1985--an increase of 9 percent over the previous year--while the overall collections workload, as measured by accounts receivable, has grown dramatically during the past year. IRS' accounts receivable, which are taxes owed but not collected, grew from \$34.4 billion in December 1984 to \$45 billion in December 1985--an increase of 31 percent.

This increase in accounts receivable is especially dramatic when compared to the overall growth of the tax system and to the historical growth in accounts receivable. During fiscal year 1985, for example, accounts receivable grew by 44 percent while IRS' net tax receipts grew by about 9 percent--that is, accounts receivable grew almost four times as much as net revenues. In comparison, the growth in accounts receivable during fiscal year 1984 was much smaller (about 15 percent) and much more comparable to the 10 percent growth in tax receipts.

We asked IRS to explain the dramatic growth in accounts receivable. IRS pointed to the following three reasons:

- The number of tax returns filed had increased by about 7 million, or 4 percent, from fiscal year 1983 to fiscal year 1985.
- The amounts owed on tax returns filed had increased from \$40.8 billion in December 1984 to \$59.6 billion in December 1985, an increase of 46 percent.
- The backlog of unposted payments and account adjustments left over from last year's filing season accounted for several billion dollars in accounts receivable.

Notwithstanding the dramatic increase in accounts receivable, neither the 1986 supplemental nor the 1987 budget request provides for additional revenue officers. IRS officials explained that they were not aware of the dramatic growth in accounts receivable at the time they were preparing those budget documents.

Although it is reasonable to assume that additional collection resources would produce benefits in excess of costs, we are not in a position to suggest that collection would be the best place to apply additional resources if they were to become available. Our hesitancy is caused by limitations in IRS' management information system, which I will discuss next.

IMPROVEMENTS NEEDED IN ALLOCATING IRS' RESOURCES

It is not too difficult to argue that IRS needs additional resources and that the increases called for in the supplemental appropriation request and the budget request for fiscal year 1987 are justified and will produce additional revenues. It is not as easy, however, to justify an increase in resources for one activity versus another--especially in the enforcement area--or to comment on whether the 1986 supplemental and the

1987 budget request, as allocated, provide for the most effective overall use of IRS resources. For example, is it best to increase examination staff by 2,652 average positions while maintaining the status quo in collections (as is proposed in the fiscal year 1987 budget request) or is some other mix better?

IRS' management information system has not provided the kind of reliable data needed to determine the overall effectiveness of its compliance programs and to help it decide how best to allocate resources among various activities. To do that, IRS needs accurate data on the cost and marginal yield associated with each of its compliance programs. Generally, however, it has data showing only "average" dollar yields. IRS' examination model allows measurements of yield "at the margin" for the examination program, but similar measurements have not been available for other compliance programs. In June 1986, however, IRS plans to implement an Enforcement Resource Allocation Model which is designed to measure marginal yield for the examination, information returns, and delinquent returns programs. We have not assessed that model to determine if it will provide the kind of reliable information needed to effectively allocate compliance resources.

BUDGET REQUEST FOR ADP AND INFORMATION TECHNOLOGY

The ADP and Information Technology part of the budget calls for \$634.2 million for fiscal year 1987. While not the largest item in the budget, it is extremely important because IRS relies so heavily upon ADP to meet its mission. Given the fact that IRS has recently made some changes in key ADP initiatives and is considering others, and given the Subcommittee's active interest in oversight, we believe that the Subcommittee could enhance its oversight activities by asking IRS to provide more information on its ADP goals and the short- and long-term budget implications of those goals. Our specific reasons for coming to this conclusion are as follows.

First, over the last few years the Congress has provided several hundred million dollars to fund ADP initiatives at IRS. These initiatives have included:

- The Service Center Replacement System to replace old computers and software which support tax returns processing.
- The Automated Examination System to introduce automation to the examination function.
- The Automated Collection System to employ automation in making telephone contact with delinquent taxpayers.
- The Integrated Data Retrieval System to bring more advanced technology to the on line system that allows access to taxpayer account information.

Second, the \$634.2 million in the 1987 budget is for a combination of new projects, maintenance of existing projects, and staffing. Among the largest dollar items are \$124.1 million for telecommunications, \$73.2 million for the Automated Collection System and \$51.3 million for the Automated Examination System. In addition, \$32.5 million is budgeted for terminals, front-end processors, and other support costs to fund the Integrated Data Retrieval System. For this latter project IRS originally awarded a contract to Computer Systems and Resources, Inc. The GSA Board of Contract Appeals overturned that award and IRS subsequently awarded the contract to SYSOREX for a systems life cycle cost of just over \$156 million, or \$59 million more than the original award. We understand that, due to the timing of the Board of Contract Appeals' decision and the

subsequent reaward, the portion of the additional cost needed for fiscal year 1987 is not included in the fiscal year 1987 budget request.

Third, IRS' ADP and Information Technology budget plans over the next few years call for several billion dollars to continue its ongoing and planned short- and long-term ADP initiatives. The long-term initiative includes bringing on line IRS' Tax System Redesign (TSR). IRS intends TSR to provide the modern technology needed to bring IRS into the 21st century and anticipates that the system, when fully implemented, will represent a life cycle cost of billions of dollars.

However, beginning with the extensive computer problems encountered in the 1985 filing season, IRS has made a number of major changes to its ADP plans and is considering other changes. For example,

- an unanticipated multi-million dollar procurement was initiated to significantly expand the Sperry systems at IRS service centers;
- another multi-million dollar project to improve the data input and initial processing of tax returns was recently scrubbed--no funds for this project are included in the fiscal year 1987 budget request;
- another multi-million dollar procurement to replace the Sperry systems is being reevaluated; funding for this project is presently planned to commence in fiscal year 1988; and
- the TSR effort is being reevaluated.

In view of (1) the changes IRS is considering in its overall game plan, (2) the millions of dollars already spent and authorized, and (3) the number of dollars to be requested in the future, the Subcommittee may want to consider asking IRS to provide a brief overview of its strategic plan--a road map, if you will--which clearly and concisely spells out how its current ADP initiatives relate to one another and how it expects to move from these initiatives to TSR. Anticipated budget requirements should also be spelled out.

POTENTIAL IMPACT OF THE GRAMM-RUDMAN-HOLLINGS ACT

Gramm-Rudman-Hollings requires that the deficit for fiscal year 1987 not exceed \$144 billion. Obviously, it is too early to determine whether sequestration will be necessary. That depends on whether the Congress and the Administration can agree on a budget that meets the act's requirements and could depend on the results of legal actions now pending before the Supreme Court. These factors aside, should a sequestering of funds become necessary for fiscal year 1987, key functions in IRS could suffer. Just how much depends on the percentage that would have to be cut from each IRS program or activity.

Sixty-eight (68) percent of IRS' fiscal year 1987 budget is devoted to funding staff-related resources. For example, IRS' 1987 budget estimates show that staff resources comprise 80 percent of the Examination and Appeals account and 72 percent of the Investigations, Collections, and Taxpayer Service account. A sequestration sufficiently large to reach IRS' staff-related resources could have a pronounced negative effect on IRS' operations.

Regarding potential impact, a cut in staff resources in the returns processing area could result in delays in the processing of tax returns and, in turn, delays in issuing refunds to

taxpayers. Such a situation could cause an increase in government interest payments if refunds are not processed in a timely manner. In the Examination and Collections Divisions, a reduction in staff would probably result in fewer dollars assessed and collected.

CONCLUSIONS

In conclusion, we believe that approval of the supplemental appropriation request for 1986 and the fiscal year 1987 budget requested by the Administration is vital to prevent further erosion of the tax system. We believe also that additional returns processing and collection resources may be warranted, even considering limitations in IRS' management information system.

It is particularly important, Mr. Chairman, that the Congress act immediately on the supplemental request for 1986. In attempting to avoid a recurrence of the processing problems it encountered last year and thus improve public confidence in the tax system, IRS has already increased its returns processing and taxpayer assistance staff levels as provided for in the supplemental request. According to the Secretary of the Treasury, if the supplemental is not approved, IRS will be forced to furlough employees in September and take other measures that will lead, in total, to an estimated revenue loss of about \$3.5 billion in fiscal years 1986 and 1987.

In closing, let me mention three points that we believe the Congress should keep in mind in deliberating on the desirability of providing IRS with more resources.

First, because workloads in various IRS activities are interrelated, funding IRS' examination initiatives for fiscal year 1987--primarily the revenue initiative--will probably have a ripple effect on other IRS functions, such as collections and appeals. That ripple effect will cause workloads in other areas to increase, which will probably generate IRS requests for additional resources in fiscal year 1988 and beyond.

Second, IRS' unique role should be recognized. IRS stands virtually alone on the "revenue side" of the government. Government-wide reductions applied to IRS will likely result in foregone revenues, thus increasing the deficit. Providing IRS with additional resources will have the opposite effect. While the tax system collected about \$743 billion in revenue in fiscal year 1985, IRS' budget for 1985 was \$3.6 billion. Thus, IRS' administration of our tax system cost about 48 cents for each \$100 collected.

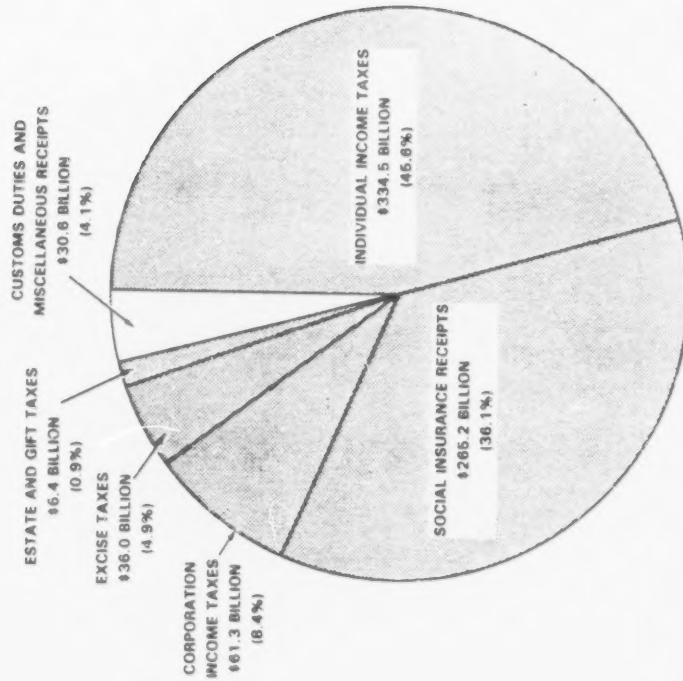
Third, it is important to keep in mind that IRS' various activities do no more than require citizens to pay those taxes that were properly due in the first place, and that were promptly paid by most of their number. Effective compliance should not be viewed as representing a special burden on the public; rather, it is aimed at ensuring that all pay their fair share.

That concludes my prepared statement. I will be pleased to answer any questions.

ATTACHMENT 1

ATTACHMENT 1

FEDERAL REVENUES FISCAL YEAR 1985 ACTUAL



Source: Office of
Management and Budget

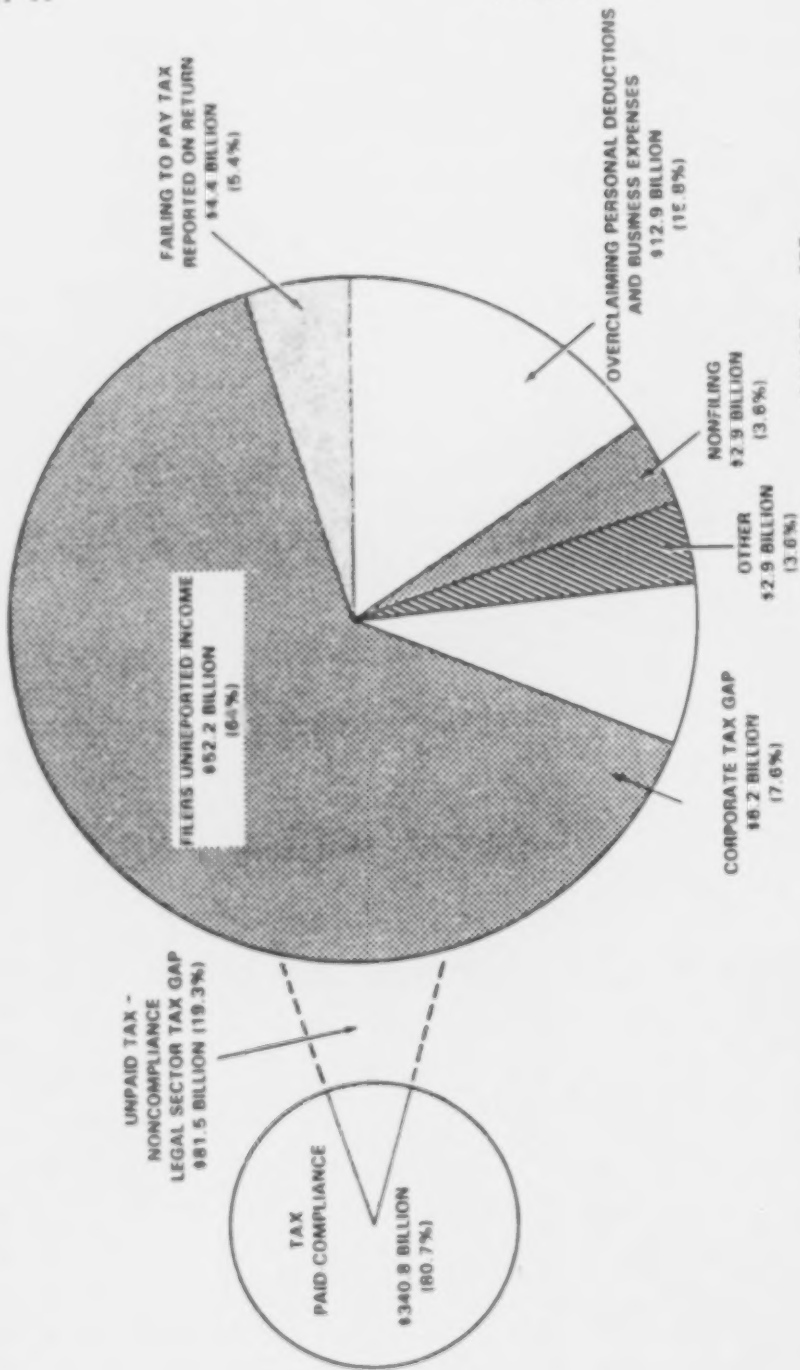
SHADED PORTION INDICATES COLLECTIONS MADE BY IRS

NOTE: THIS CHART SHOWS RECEIPTS ONLY. IT DOES NOT SHOW THAT PORTION OF THE BUDGET FINANCED THROUGH BORROWING. ALSO, A SMALL PORTION OF THE EXCISE TAX COLLECTIONS IS THE RESPONSIBILITY OF THE BUREAU OF ALCOHOL, TOBACCO AND FIREARMS, DEPARTMENT OF THE TREASURY.

ATTACHMENT II

ATTACHMENT II

ESTIMATED LEGAL SECTOR TAX GAP IN 1981



SOURCE: IRS

ATTACHMENT 111

ATTACHMENT 111

**IRS Resources and Workload by Program
Fiscal Years 1976, 1985, 1987**

Program	FY 1976		FY 1985		FY 1987		Change 1976-87	
	Workload (000)	Staff Years (Note a)	Workload (000)	Staff Years	Workload (000)	Staff Years	Workload (Percent)	Staff Years (Percent)
Examination (Note b)	89,200	28,164	103,329	29,009	112,373	32,484	26.0	15.3
Collection Delinquent Accounts	3,441	8,617	4,405	14,042	3,517	12,464	2.2	44.6
Delinquent Returns	1,115	1,693	2,526	3,898	2,644	3,499	137.1	106.7
Returns Compliance (Note c)	248	405	7	192	10	105	96.0	74.1
Criminal Investigation (Note d)	8.1	4,090	6.1	4,686	6.0	4,408	25.9	7.8
Information Returns (Note e)	471,579	1,700 (Note g)	783,000	4,467	931,000	5,767	97.4	239.2
Returns Processing	123,101	26,436	170,021	24,449	178,622	25,844	45.1	2.2
Taxpayer Service (Note f)	38,600	4,582	50,708	4,584	45,657	4,860	18.3	6.1
Total IRS Staff Years		84,264		92,259		95,084		12.8
Total IRS Appropriation		\$1,691,520 (000)		\$3,574,597 (000)		\$4,097,792 (000)		142.3

^(a) 1976 staff years are not adjusted to reflect organizational shifts

^(b) Examination workload is prior calendar year income, estate, gift and partnership returns filed

^(c) Returns compliance workload is number of delinquent returns secured

^(d) Criminal Investigation workload is number of investigations initiated during the fiscal year.

^(e) Information returns is a multifunctional program and some of the staff years shown for that program are also included in the staff years for other programs listed above

^(f) Taxpayer Service workload is taxpayers assisted

^(g) Estimate

SOURCE: IRS

ATTACHMENT IV

ATTACHMENT IV

Comparison of IRS' Fiscal Year 1986 Continuing Resolution, Revised Fiscal Year 1986 Budget, and
Fiscal Year 1987 Proposed Budget
Summary of Staffing

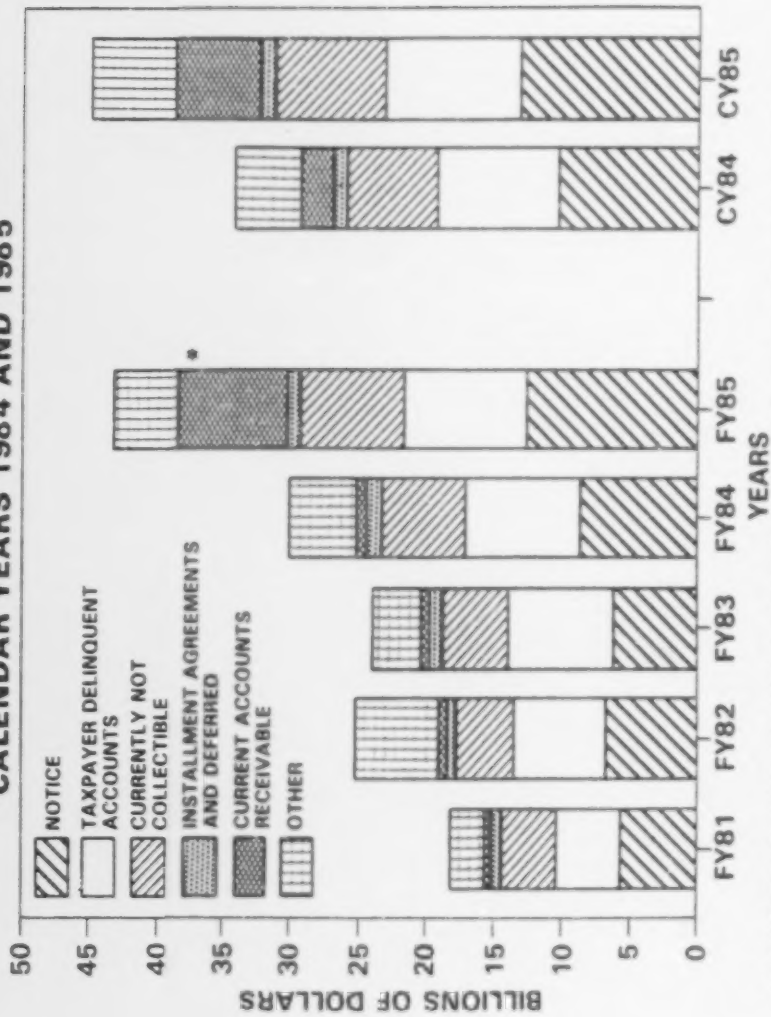
IRS Program	FY86 C.R.	FY86 Rev.	FY87	Change from C.R. to FY87		Change from Rev 86 to FY87	
				Amount	Percent	Amount	Percent
Executive Direction	127	127	122	(5)	-3.94	(5)	-3.94
Management Services	1,944	1,944	1,922	(22)	-1.13	(22)	-1.13
Sub total	2,071	2,071	2,044	(27)	-1.30	(27)	-1.30
Returns Processing and Revenue Accounting	21,621	27,434	25,844	4,223	19.53	11,590	5.80
Computer Services	1,510	1,510	1,483	(27)	-1.79	(27)	-1.79
Sub total	23,131	28,944	27,327	4,196	18.14	11,617	5.59
Examination	29,518	29,922	32,484	2,966	10.05	2,562	8.56
Appeals and Tax Litigation	3,537	3,600	4,097	560	15.83	497	13.81
Employee Plans and Exempt Organizations	2,401	2,401	2,393	(8)	-0.33	(8)	-0.33
Sub total	35,456	35,923	38,974	3,518	9.92	3,051	8.49
Tax Fraud Investigations	4,413	4,413	4,408	(5)	0.11	(5)	0.11
Collection	16,056	16,056	16,068	12	0.07	12	0.07
Taxpayer Service	4,214	4,884	4,860	646	15.33	(24)	-0.49
Enforcement Litigation and Rulings	1,433	1,433	1,403	(30)	-2.09	(30)	-2.09
Sub total	26,116	26,786	26,739	623	2.39	(47)	-0.18
Total	86,774	93,724	95,084	8,310	9.58	1,360	1.45

SOURCE: IRS

ATTACHMENT V

ATTACHMENT V

STATUS OF ACCOUNTS RECEIVABLE AT END OF FISCAL YEARS 1981-1985 AND END OF CALENDAR YEARS 1984 AND 1985

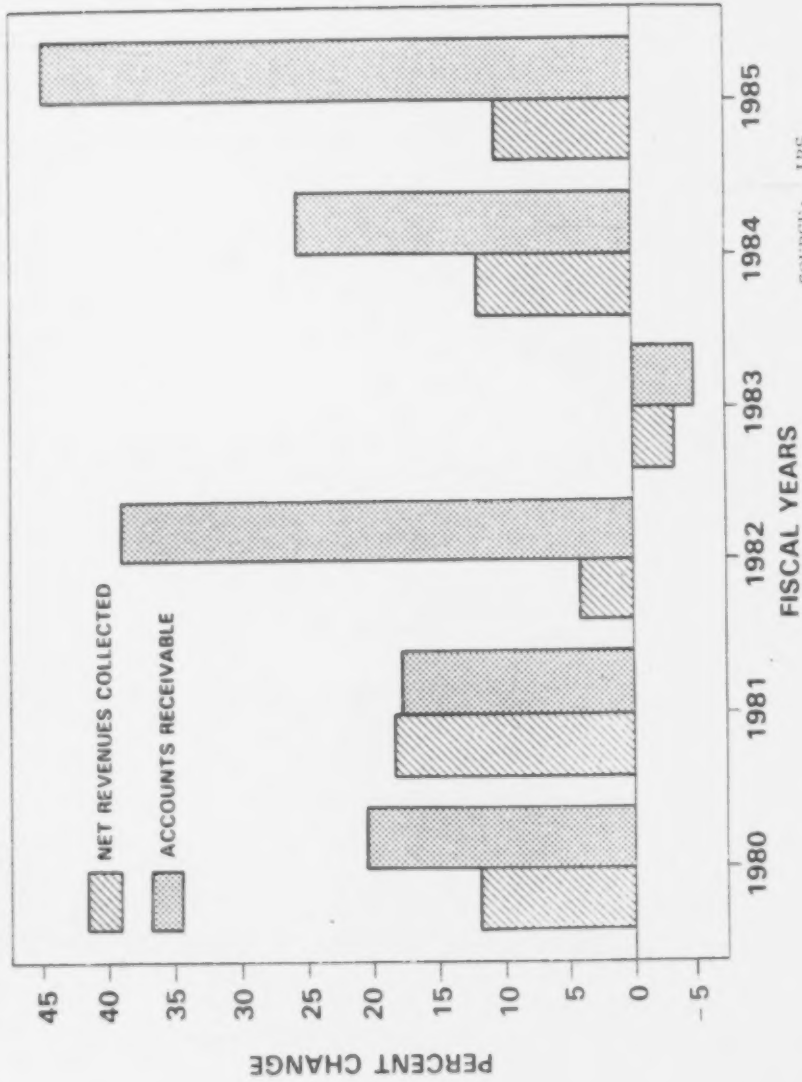


* AN ACCOUNTING CHANGE WAS MADE IN FISCAL YEAR 85 THAT RECLASSIFIED BALANCE DUE NOTICES UNDER 30 DAYS FROM DELINQUENT TO CURRENT STATUS.

ATTACHMENT VI

ATTACHMENT VI

PERCENT CHANGES IN ACCOUNTS RECEIVABLE AND COLLECTIONS



ATTACHMENT VII

ATTACHMENT VII

Yield/Average Cost Estimates¹ for Selected IRS Programs
Fiscal Years 1984 through 1987
(Dollars in Millions)

Examination	FY 1984	FY 1985	FY 1986 ³	FY 1987 ³
Yield				
Cost	\$10,428	\$12,615	\$10,433	\$11,296
Ratio	\$997.3	\$1,081.5	\$1,130.1	\$1,266.4
	10.46	11.66	9.23	8.92
Criminal Investigations				
Investigations				
Cost	8,194	6,065	5,962	6,027
Cost/Inv. ²	\$204.1	\$220.0	\$210.8	\$223.8
	\$32,951	\$36,274	\$35,357	\$37,133
Accounts Receivable				
Yield	\$8,928	\$9,062	\$8,684	\$8,889
Cost	\$459.2	\$473.3	\$488.4	\$506.5
Ratio	19.44	19.15	17.78	17.48
Delinquency Investigations				
Yield ²				
Cost	\$5,660	\$5,663	\$5,299	\$5,449
Ratio	\$109.0	\$103.2	\$86.5	\$92.5
	51.93	54.87	61.26	58.91
Returns Compliance				
Yield	\$17	\$10	\$12	\$15
Cost	\$4.4	\$6.6	\$3.5	\$3.8
Ratio	3.86	1.52	3.43	3.95
Document Matching				
Yield	\$1,562	\$2,352	\$2,711	\$3,014
Cost	\$116.4	\$135.1	\$154.0	\$186.7
Ratio	13.42	17.41	17.60	16.14

¹Yield is shown in millions of dollars of net assessments except for the Criminal Investigations Program and the Accounts Receivable Program. The Criminal Investigation Program is measured in total investigations; the Accounts Receivable Program in collections after the first notice.

²Cost per investigation is total dollar cost.

³Estimated

⁴Assessments shown for Delinquency Investigations are before any offsets for refunds; additionally, the amount ultimately collected would be less.

Source: IRS

ATTACHMENT VIII

ATTACHMENT VIII

Comparison of IRS' Personnel and Non-Personnel Resources
Fiscal Year 1984, 1985 and 1987 Appropriations

Standard Object Classification	Summary		Summary		Summary	
	1984	Percent	1985	Percent	1987	Percent
	Appropriation (\$ In Thousands)		Appropriation (\$ In Thousands)		Appropriation (\$ In Thousands)	
Personnel Costs						
Permanent Positions	1,839,633	55.32	1,978,661	55.35	2,030,777	49.56
Temporary Positions	206,743	6.22	244,358	6.84	215,106	5.25
Other Personnel Compensation	62,827	1.89	71,342	2.00	58,193	1.42
Special Personnel Service Payments	11,323	0.34	5,393	0.15	9,522	0.23
Personnel Benefits	267,498	8.04	302,470	8.46	346,793	8.46
Benefits for Former Personnel	16,158	0.49	17,351	0.49	18,930	0.46
Travel and Transportation of Persons	99,995	3.01	91,951	2.57	121,337	2.96
Total Personnel Costs	2,504,177	75.30	2,711,532	75.86	2,800,658	68.35
Non Personnel Costs						
Transportation of Things	27,540	0.83	29,054	0.81	27,625	0.67
Standard Level User Charges	187,737	5.85	225,933	6.32	272,256	6.64
Rental Payments to Others		0.00	477	0.01	687	0.02
Other Rent, Communications, Util	229,405	6.90	264,011	7.39	397,104	9.69
Printing Reproduction	68,542	2.06	79,638	2.23	94,461	2.31
Other Services	136,672	4.11	174,114	4.87	222,914	5.44
Supplies and Materials	36,770	1.11	36,340	1.02	53,117	1.30
Equipment	86,171	2.59	77,496	2.17	69,993	1.70
Grants, Subsidies, and Contribu	1,703	0.05	1,936	0.05	2,200	0.05
Insurance Claims and Indemnities	250	0.01	422	0.01	538	0.01
Total Non Personnel Costs	774,890	23.30	869,421	24.88	1,140,495	27.83
Undistributed					156,639	3.82
Unobligated Balance	6,299	0.19	7,647	0.07		
Unobligated Balance Available Start of Year	124,068	0.72	164,332	1.80		
Unobligated Balance Available End of Year	64,332	1.93	35,329	0.99		
Total Appropriation	3,325,830	100.00	3,574,597	100.00	4,097,792	100.00

SOURCE: IRS

ATTACHMENT IX

ATTACHMENT IX

**Analysis of IRS' Fiscal Year 1987 Budget Request of
Personnel and Non-personnel Funding Levels**

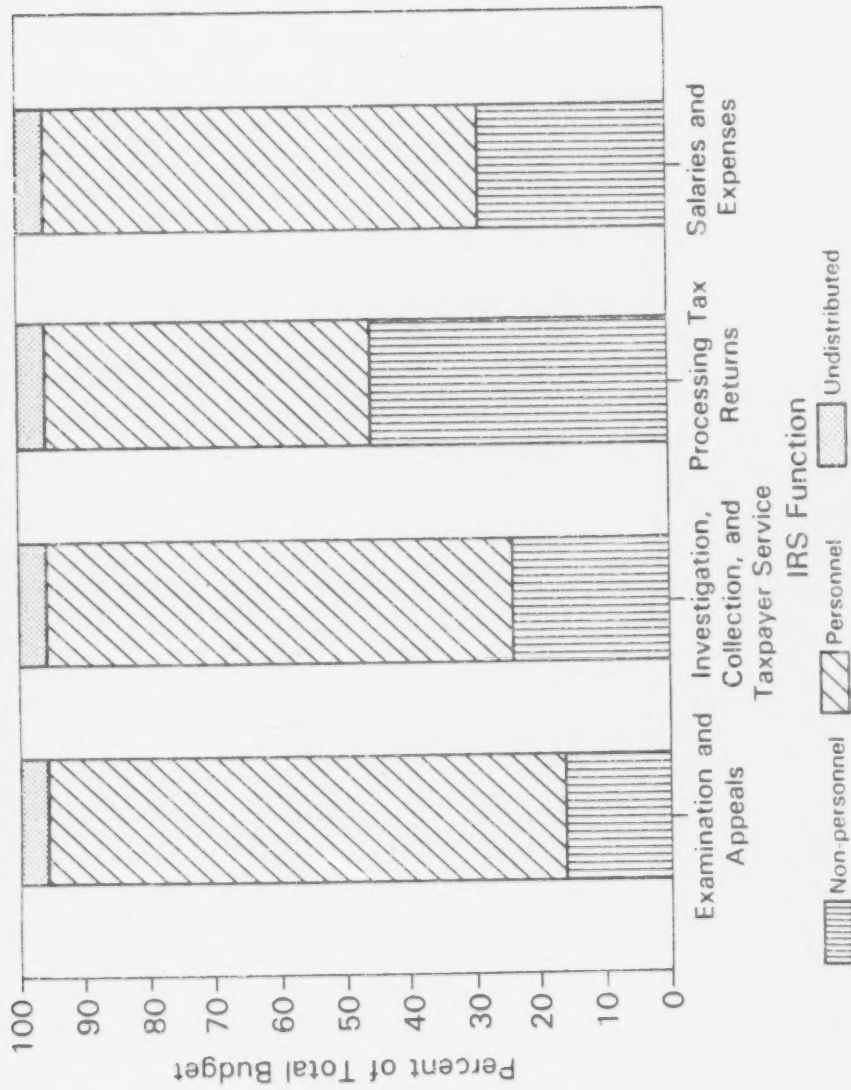
Standard Object Classification	Examination & Appeals		Investigation, Collection, and Taxpayer Service		Processing Tax Returns		Salaries & Expenses	
	1987 Appropriation (\$ in Thousands)	Percent	1987 Appropriation (\$ in Thousands)	Percent	1987 Appropriation (\$ in Thousands)	Percent	1987 Appropriation (\$ in Thousands)	Percent
Personnel Costs								
Permanent Positions	1,001,257	62.46	616,085	54.21	362,038	28.67	51,397	54.02
Positions - Non Permanent	30,632	1.91	36,788	3.24	146,628	11.61	1,058	1.11
Utility Compensation	9,543	0.60	30,520	2.69	16,039	1.27	2,091	2.20
Special Personnel Service	7,467	0.47	1,718	0.15	304	0.02	43	0.05
Personnel Benefits	163,106	10.17	95,916	8.44	80,203	6.35	7,568	7.95
Benefits for Former Personnel	0	0.00	0	0.00	18,930	1.50	0	0.00
Travel transport of Persons	70,124	4.37	37,456	3.30	12,097	0.96	1,660	1.74
Total Personnel Costs	1,262,119	79.98	818,483	72.01	636,239	50.38	63,817	67.07
Non personnel Costs								
Transportation of Things	3,755	0.23	3,087	0.27	20,485	1.62	298	0.31
Standard Level User Charges	101,186	6.31	86,164	7.58	80,183	6.35	4,721	0.96
Rental Payments to Others	217	0.01	182	0.02	287	0.02	1	0.00
Other Rent, Communications, Util	68,724	4.29	106,032	9.33	215,246	17.04	7,102	7.46
Printing reproduction	12,177	0.76	9,179	0.81	72,842	5.77	263	0.28
Other Services	37,147	2.32	41,874	3.68	133,002	10.53	10,891	11.45
Supplies and Materials	12,790	0.80	8,960	0.79	28,973	2.36	2,394	2.52
Equipment	23,834	1.49	14,522	1.28	29,747	2.38	1,490	1.57
Grants, Subsidies, and Contribu	0	0.00	2,200	0.19	0	0.00	0	0.00
Insurance Claims and Indemnities	175	0.01	132	0.01	103	0.01	128	0.13
Total Non personnel costs	260,007	16.22	272,332	23.96	560,868	45.99	27,268	28.68
Undistributed	61,036	3.81	45,766	4.03	45,795	3.63	4,042	4.25
Total Budget	1,603,162	100.00	1,136,581	100.00	1,262,902	100.00	95,147	100.00

SOURCE: IRS

ATTACHMENT X

ATTACHMENT X

IRS' Fiscal Year 1987 Budget Request Comparison of Personnel and Nonpersonnel Funding



Chairman PICKLE. Thank you, Mr. Finch. Those are good recommendations.

Now, Mr. Tobias, if you will proceed.

**STATEMENT OF ROBERT M. TOBIAS, PRESIDENT, NATIONAL
TREASURY EMPLOYEES UNION**

Mr. TOBIAS. Thank you very much, Mr. Chairman. I appreciate very much being asked to testify before this committee. I agree with those who have testified before that the most serious problem facing the Nation's tax system today is the need to stem the fall in voluntary compliance. We see the gap that has increased over time where now it is approaching \$100 billion today and will rise to \$159 billion by 1990.

The failure to confront this problem is a national failure, a failure for which the present administration bears a large burden of responsibility. Not until after it had plunged the tax system to its lowest performance in history, not until after the humiliating events of the last filing season, not until millions of irate citizens raised their voices in indignation, did the administration come forward with a sensible budget for Internal Revenue Service in the current fiscal year.

We must place high on the national agenda the goal of halting the decline in voluntary compliance. And we must provide the Internal Revenue Service with the resources necessary to achieve this goal.

Effective tax enforcement sends the message that those who do not pay their fair share will be caught and required to pay. It is a bulwark of voluntary compliance.

We welcome the administration's supplemental request for \$340 million for fiscal year 1986. After deducting the Gramm-Rudman cut of \$157 million, there will be a net addition to Internal Revenue Service resources of \$183 million and 7,000 average positions. These resources are urgently required to assure efficient processing of 6 million additional returns and refunds, to strengthen taxpayer services, and to commence hiring 2,500 additional revenue agents and tax auditors that are sorely needed and long overdue. Of course, because of the delay in the passage of the \$340 million supplemental request, the hiring of these 2,500 additional revenue agents and tax auditors has been put off which is going to have an impact on the ability to hire these people, train them, and will have an impact on the amount of revenue they will generate in fiscal year 1987 and beyond.

Unfortunately, the Office of Management and Budget has a fleeting attention span because its fiscal year 1987 request for Internal Revenue Service is a reversion to the discredited policies that led to the 1985 fiasco.

Internal Revenue Service says that it needs 4,300 additional positions, yet the budget provides a net increase of 1,360 average positions. The remaining resources are to be obtained from within Internal Revenue Service, by reducing returns processing. The 10 Internal Revenue Service service centers will be required to process 178 million primary returns in fiscal year 1987, an increase of 8.6 million over fiscal year 1985. Individual tax refunds will be sched-

uled for 1.8 million more taxpayers than in 1985. The information returns program will have to process approximately 38 million additional information returns and issue 1.25 million more underreporters notices than currently.

In light of this workload growth, the administration's budget request for returns processing is completely unrealistic and should be rejected.

Moreover, to ratchet the returns processing staff level down again in the face of rising workload is to miss completely the lesson of 1985. From fiscal year 1980 to fiscal year 1984, the Office of Management and Budget reduced the returns processing staff by 7,000 positions, draining all reserves out of the system and reducing the flexibility needed to cope with unforeseen developments. As Commissioner Egger himself has testified, this contributed significantly to the disastrous 1985 filing season.

There are two other glaring deficiencies in this budget. First, the number of taxpayers assisted through toll-free telephone, walk-in, and correspondence is projected to fall from 50 to 45 million. There is no justification for such a decrease, particularly if tax reform should be enacted this year.

Second, the collection staff is to be cut 1,500 positions and the number of revenue officers working past-due accounts is to be held constant for the fourth year in a row, despite mounting caseloads. In view of the increasing number of delinquent accounts, the total of more than \$30 billion owed in such accounts, and the return of \$20 for each dollar spent in collection, we believe there is no justification for ratcheting down the staff level.

In conclusion, Mr. Chairman, we strongly urge Congress to approve a budget which substantially increases the resources available to Internal Revenue Service in fiscal year 1987. I know that Commissioner Owens says he can absorb some 3,000 positions in enforcement in fiscal year 1987. In my written statement that I have submitted to this committee, we urge 4,700 additional positions, some in enforcement and some in taxpayer service. We believe that Internal Revenue Service can absorb all those positions and make them work.

The minimum increase that should be considered, if we are to maintain fiscal year 1985 program levels and accommodate normal workload growth, is NTEU's recommendation for 4,700 additional staff-years and \$130.9 million. This program would raise \$570 million in fiscal year 1987, and \$2.8 billion over the period fiscal years 1987-89, over the revenue that would accrue under the administration's budget request.

We also urge, Mr. Chairman, that Congress direct the Internal Revenue Service to prepare a 5-year plan so that we don't see this yo-yo kind of management of up and down and the kind of resource allocation syndrome of putting your finger in the dike from 1 year to another. We think there ought to be a plan, we think Internal Revenue Service ought to stick to it, we think Congress ought to know what it is and support the Internal Revenue Service in its endeavors.

Congress has a rare opportunity not only to reverse the trend of deteriorating voluntary compliance, but to raise significant revenues during a time of crisis in the Federal budget. The enormous

size of the tax compliance gap means that additional revenues can be rapidly obtained. The success of past revenue initiatives bears this out. Both the Congressional Budget Office and the General Accounting Office, chief advisers to the Congress in these matters, have emphasized the revenue yield to be gained when relatively small increments of resources are added to the tremendous plant already in existence.

Mr. Chairman, I appreciate the opportunity to appear before you today. I am prepared to answer any questions you may have.

Chairman PICKLE. Thank you, Mr. Tobias.

[The statement of Mr. Tobias and letter addressed to Chairman Pickle follow:]

STATEMENT OF

ROBERT M. TOBIAS
NATIONAL PRESIDENT

NATIONAL TREASURY EMPLOYEES UNION

Mr. Chairman and Members of the Subcommittee:

I am Robert M. Tobias, National President of the National Treasury Employees Union. Our union is the exclusive representative of over 120,000 Federal workers, including virtually all employees of the Internal Revenue Service.

The most serious problem facing the nation's tax system today is the need to stem the fall in voluntary compliance. IRS projects voluntary compliance to fall from 81.6 percent this year to 79 percent by 1991. This amount may not appear large, but it is enormous when you consider that for each 1 percent decline, \$7 billion is lost to the Treasury. Viewed in historical perspective, compliance was around 90 percent in the sixties, fell to 84 percent by 1975, and has been declining steadily since then. As a result, the tax gap -- the difference between taxes legally owed and those voluntarily paid -- stands at \$100 billion today and will rise to \$159 billion by 1990.

There has been a hardening of cynicism toward their tax obligation on the part of many of our citizens. In the words of the General Accounting Office, there is a trend toward contempt and abuse of the system that undermines the compliance of others. An opinion survey conducted for IRS by Yankelovich, Skelly and White found that 20 percent of the sample admitted to cheating on their taxes, and a third believe that it is all right to cheat because others do so. The belief that others cheat and get away with it is the basic reason for non-compliance.

The failure to confront this problem is a national failure -- a failure for which the present Administration bears a large burden of responsibility. Not until after it had plunged the tax system to its lowest performance in history, not until after the humiliating events of the last filing season, not until millions of irate citizens raised their voices in indignation, did the Administration come forward with a sensible budget for IRS in the current fiscal year.

We believe there is still time to restore the system's health but, quite frankly, Mr. Chairman, we have been saying this for six years and time is slipping away.

We must place high on the national agenda the goal of halting the decline in voluntary compliance. And we must provide IRS with the resources necessary to achieve this goal.

Strengthening tax enforcement by examining more returns, collecting more past-due accounts, and putting abusive tax shelters out of business should not be viewed as an imposition on our citizens. I know that many people -- perhaps including some in this room -- believe that IRS should not be "unduly intrusive" into their lives. That philosophy has led to six straight years of declining audit coverage and rampant cheating. In the 1960's, audit coverage was more than 5% and yet our freedoms did not suffer. Effective tax enforcement sends the message that those who do not pay their fair share will be caught and required to pay. It is a bulwark of voluntary compliance.

We welcome the Administration's supplemental request for \$340 million for FY 1986. After deducting the Gramm-Rudman cut of \$157 million, there will be a net addition to IRS resources of \$183 million and 7,000 average positions. These resources are urgently required to assure efficient processing of 6 million additional returns and refunds, to strengthen taxpayer services, and to commence hiring 2,500 additional Revenue Agents and Tax Auditors that are sorely needed and long overdue.

Unfortunately, OMB has a fleeting attention span, because its FY 1987 request for IRS is a reversion to the discredited policies that led to the 1985 fiasco. The evidence on this point is clear. In this budget, OMB authorizes four important program initiatives -- a revenue initiative to strengthen Examinations, a Tax Shelter Initiative to clear up the backlog in Appeals, a Document Matching Initiative to improve collections from underreporters, and an ADP Initiative to strengthen returns processing. These initiatives are essential and long overdue. To implement them, and allow for processing additional returns, 4,300 average positions are required.

Yet the budget provides a net increase of only 1,360 average positions. The remaining resources are to be obtained from within IRS, by reducing Returns Processing. (Table 1) The ten IRS Service Centers will be required to process 178 million primary returns in FY 1987, an increase of 8.6 million over FY 1985. Individual tax refunds will be scheduled for 1.8 million more taxpayers than in 1985. The Information Returns Program will have to process approximately 38 million additional information returns and issue 1.25 million more underreporter notices than currently. (Table 2)

In light of this workload growth, the Administration's budget request for Returns Processing is completely unrealistic and should be rejected. The budget document states that 1,143 additional positions will be required in FY 1987, consisting of 660 positions to strengthen the Information Returns Program, 473 positions to process additional returns, and 10 positions for the ADP program. Added to the FY 1986 level of 28,944 positions, this means that a total of 30,087 positions are required in FY 1987.

By contrast, the Administration's budget allows 27,327 positions, a shortfall of 2,760 positions over the number it admits are required. The Administration claims that these positions are "non-recurring", that they were utilized to clean up backlogs during FY 1985 and FY 1986, and will no longer be required once this work has been completed. NTEU's view is that employees completing assigned projects should be directed to other work, which is obviously at hand from the increased work requirements spelled out in the budget.

Moreover, to ratchet the Returns Processing staff level down again in the face of rising workload is to miss completely the lesson of 1985. From FY 1980 to FY 1984, OMB reduced Returns Processing staff by 7,000 positions, draining all reserves out of the system and reducing the flexibility needed to cope with unforeseen developments. As the Commissioner himself has testified, this contributed significantly to the disastrous 1985 filing season.

A large and growing gap between IRS workload and resources has emerged over the past decade. The deterioration in compliance we are witnessing stems in large measure from the generally inadequate level of resources provided. The number of primary returns filed will increase 43 percent between 1975 and 1987. In contrast, total staff years will increase only 15 percent, even with the significant additions in FY 1986-87.

As more people enter the labor force, the number of taxpayers increases and so do the number of tax returns filed. Without changing the tax law, this basic workload is uncontrollable. A growing number of returns must be processed, refunds scheduled, examinations conducted, and accounts collected. The increasing complexity of our tax laws adds to the basic workload by making the processing of returns more time-consuming.

At the same time, compliance problems posed by tax protesters, tax shelters, and the underground economy have risen in magnitude. New missions, such as implementing the Deficit Reduction Act, and the Interest and Dividends Tax Compliance Act, have proliferated. Billions of dollars in past-due taxes have accumulated. Offshore tax havens have emerged as a major new challenge.

The disparity between workload and resources that has been accumulating for a dozen years has plunged the tax administration system to the lowest levels of performance in history. Audit coverage in FY 1986 will be the lowest ever, 1.1 percent. This marks the sixth straight year in which coverage has remained below 2 percent. Because of fewer examinations, additional tax assessments will fall from \$17.7 billion in FY 1985 to \$14.4 billion in FY 1986, a loss of \$3.3 billion dollars.

The Appeals backlog will raise from 66,000 to 120,000 cases between FY 1985 and FY 1986 due to the large number of tax shelter cases under examination. This represents an 81 percent increase in a single year. Because of static resources, the average caseload per appeals officer will leap 60 percent.

Delinquent returns secured from non-filers will be 17,000 fewer this year and \$523 million less revenue will be collected in the delinquent returns program than in FY 1985. Delinquent returns investigations are increasing faster than dispositions, causing the caseload backlog to rise by 483,000 cases or 78 percent over FY 1984, at a time when top priority should be given to reducing this backlog. The number of average positions working delinquent returns fell from 4,389 in FY 1984 to 3,898 in FY 1985, and will fall again to 3,499 this year. This is a 20 percent decline in two years. The number of delinquent returns investigations closed will fall by 96,000 during this period.

The backlog buildup in delinquent returns clearly illustrates what has come to be accepted management practice in IRS. Due to inadequate budgets, resources are shifted into the most pressing programs while other programs are starved until unacceptable backlogs result. Then and only then is OMB persuaded to authorize an "initiative" for one

or two years to clean up the backlog. In the meantime, the statute of limitations continues to run, and many leads are lost due to caseload aging.

As a result of this policy, IRS programs are chronically out of balance. One-time shots of resources to clean up backlogs only aggravate the problem, for it is likely that some other program will be reduced to provide the resources. Not only is the overall IRS staffing level ratcheted up and down by OMB, but the staffing levels of major functions within IRS are being ratcheted in the same manner by this stop-and-go system.

This problem is starkly illustrated by several examples in recent years:

- o The number of taxpayer delinquent account in Collection was allowed to rise between 1978 and 1982 until a huge backlog was created. Finally, in 1983 4,000 positions were added to that function to clean up the backlog. A total of 1,700 of these positions were taken from IRS programs. While the backlog has been reduced, it is still not at manageable levels. Yet the FY 1987 budget calls for a 2,000 position reduction in Collection staff.
- o After staff-years in Returns Processing were reduced by 7,000 positions between 1980 and 1984, a collapse took place in this function in 1985. The situation was only restored by an infusion of 7,200 positions in FY 1985 and FY 1986 (bringing Returns Processing back to the level of 1980--see Table 3). In the FY 1987 budget, OMB begins to repeat the earlier pattern. With 30,000 positions required (this is admitted in the budget submission itself) to process a growing volume of returns, only 27,300 are allowed--a reduction of 2,700 positions.
- o Between 1980 and 1986, the number of returns examined fell constantly and millions of returns with audit potential went unexamined (Table 3). After six years of serious deterioration in compliance, IRS will soon commence hiring the first of 7,500 positions to be added (2,500 per year) during FY 1987-89. Additional revenue of \$10.3 billion will be generated by this program over 5 years. Much more than this has already been lost since 1980: at least \$12 billion in direct enforcement revenue, and another \$11 billion from the fall in voluntary compliance from 82.1 to 81.6 percent.
- o As a result of very necessary program emphasis on tax shelter cases, the backlog in Appeals has grown to unmanageable proportions during the past four years. For FY 1987, IRS is requesting a "tax shelter initiative" of 465 positions to reduce this backlog. However, the amount requested is insufficient as the backlog is projected to continue growing.

The consequences of this pattern of the voluntary compliance system are obvious and severe. Mounting unpaid tax bills, unexamined returns, correspondence backlogs and periodic breakdowns in processing returns and refunds--all take a severe toll on compliance. Considering the extraordinary harm inflicted, it is unfortunate that a system of actively preventing imbalances has not been grasped by OMB.

The interesting thing about these episodes is that all of the conditions were predictable, and were known to management and OMB. To its credit, IRS requested far more resources than OMB granted. Instead of increasing resources in step with workload, maintaining the tax administration system in balance, OMB's policy has been one of first causing imbalances by denying needed resources, and then plugging the gaps when the situation got out of hand. OMB has been both arsonist and fireman in this absurd style of management.

The General Accounting Office has taken issue with OMB on this score. It stated:

"This ratcheting of staffing levels makes it extremely difficult to develop well-founded plans for acquiring, training, and focusing human resources on the multi-faceted task of administering the tax system. A larger and more consistent level of resources to keep pace with growing demand on the tax system appears in order."

NTEU would like to bring to the attention of the Subcommittee the new IRS policy of contracting out to private entities the processing of confidential estimated tax forms (1040-ES). This practice is now underway in Atlanta, where the Citizens and Southern Bank was awarded a contract to process the returns of Florida residents and in Chicago, where the First National Bank of Chicago is processing the returns of Chicago residents. The taxpayers involved have no knowledge of what is happening, as the forms are addressed to IRS at a post office box leased by the banks. In view of the importance Congress and the American people attach to the confidentiality of tax returns, and the obvious danger of compromising the security of returns and computer tapes holding taxpayer information once they are out of IRS control, NTEU strongly urges Congress to bar the use of appropriated funds to administer these activities.

There are two other glaring deficiencies in this budget. First, the number of taxpayers assisted through toll-free telephone, walk-in, and correspondence is projected to fall from 50 to 45 million. There is no justification for such a decrease, particularly if tax reform should be enacted this year.

Second, the Collection staff is to be cut 1,500 positions and the number of Revenue Officers working past-due accounts is to be held constant for the fourth year in a row, despite mounting caseloads. In view of the increasing number of delinquent accounts, the total of more

than \$30 billion owed in such accounts, and the return of \$20 for each dollar spent in Collection, we believe there is no justification for ratcheting down the staff level.

Conclusion

In conclusion, Mr. Chairman, we strongly urge Congress to approve a budget which substantially increases the resources available to IRS in FY 1987. The minimum increase that should be considered, if we are to maintain FY 1985 program levels and accommodate normal workload growth, is NTEU's recommendation for 4,700 additional staff-years and \$130.9 million. This program would raise \$570 million in FY 1987, and \$2.8 billion over the period FY 1987-1989, over the revenue that would accrue under the Administration's budget request (Table 4).

Congress has a rare opportunity not only to reverse the trend of deteriorating voluntary compliance, but to raise significant revenues during a time of crisis in the Federal budget. The enormous size of the tax compliance gap means that additional revenues can be rapidly obtained. The success of past revenue initiatives bears this out. Both the Congressional Budget Office and the General Accounting Office, chief advisors to the Congress in these matters, have emphasized the revenue yield to be gained when relatively small increments of resources are added to the tremendous plant already in existence.

Mr. Chairman, I appreciate the opportunity to appear before you today. I am prepared to answer any questions you may have.

TABLE 1
INTERNAL REVENUE SERVICE FY 87 BUDGET REQUEST AND NTEU RECOMMENDATION

	FY 86 CONTINUING RESOLUTION AND SUPPLEMENTAL ¹		FY 87 BUDGET REQUEST		INCREASE OR DECREASE		NTEU RECOMMENDED ADDITION TO RESTORE TO FY86 LEVEL AND PROVIDE FOR WORKLOAD GROWTH ²		NTEU RECOMMENDED APPROPRIATION FOR FY 1987	
	(\$000) Amount	Average Positions	(\$000) Amount	Average Positions	(\$000) Amount	Average Positions	(\$000) Amount	Average Positions	(\$000) Amount	Average Positions
Salaries and expenses	89,958	2,071	95,147	2,044	+5,189	-27			95,147	2,044
Processing Tax Returns	1,213,769	28,944	1,262,902	27,327	+49,133	-1,617	+68,325	+2,700	1,331,227	30,027
Examination and Appeals	1,427,121	35,923	1,603,162	38,974	+176,041	+3,051			1,603,162	38,974
Investigation Collection & Taxpayer Service	1,095,289	26,786	1,136,581	26,739	+41,292	-47	+62,550	+2,000	1,199,131	28,739
TOTAL	3,826,137	93,724	4,097,792	95,084	+271,655	+1,360	+130,875	+4,700	4,228,667	99,784

¹ Includes Supplemental Appropriation of \$340 million and 6,950 positions, and Gramm-Rudman cut of \$156.6 million.

² Includes restoration of 2,700 positions eliminated on assumption that current filing and processing backlog problems have been corrected, additional 500 positions for taxpayer service to maintain FY 85 level of assistance (50.2 million taxpayers assisted), and 1500 positions for collection to maintain FY 1985 staff levels and collect \$570 million annually in additional revenue from delinquent accounts.

TABLE 2
INTERNAL REVENUE SERVICE STAFFING COMPARED TO WORKLOAD
1975-1987

Illustrating Ratcheting of Staffing Levels that GAO
Has Criticized as Inefficient

	<u>Total Staff Positions</u>	<u>Returns Processing Positions</u>	<u>Primary Returns Filed (000)</u>	<u>Information Returns (000)</u>
1975	82,339		125,096	
1976	84,264		123,100	
1977	83,743		127,800	
1978	85,329		129,100	
1979	86,168		134,700	
1980	87,464	28,744	137,382	547,000
1981	86,136	27,481	138,763	645,000
1982	82,857	23,919	162,814	664,000
1983	83,603	20,533	171,174	678,000
1984	87,635	21,743	164,626	692,000
1985	92,254	26,075	170,021	783,000
1986	93,724	28,944	175,868	893,000
1987	95,084	27,327	178,622	931,000

TABLE 3
EXAMINATION OF TAX RETURNS
FY 1976-1987

	<u>Examination Staff-Years</u>	<u>Number of Examined Tax Returns (000)</u>	<u>Percentage of Tax Returns Examined</u>
1976	28,100	2,285	2.6%
1980	28,412	2,179	2.1%
1981	27,402	1,930	1.84%
1982	28,117	1,731	1.63%
1983	27,638	1,676	1.56%
1984	28,050	1,418	1.31%
1985	29,009	1,380	1.34%
1986 (EST)	29,922	1,271	1.14%
1987 (EST)	32,484	1,596	1.42%

TABLE 4
NTEU FY 87 RECOMMENDATION AND NET REVENUE GENERATED, FY 1987-FY 1991

(Staff- Years)	Recommended Additions for FY 87 (Millions)	Additional Revenue Collected		Cost FY 87 -FY 91 (Millions)	Net Increase in Revenue FY 87-91 (Millions)
		FY 87 (Millions)	FY 87-91 (Millions)		
1) Tax	+2,700	68.3	-0-	342	-342
2)	+1,500	46.9	2,850	235	+2,615
	+500	15.6	-0-	78	-78
	+4,700	130.8	2,850	655	+2,195

1 NTEU would avoid at all cost ratcheting staffing levels down again and run the risk of being unable to process the 3.5 million additional returns and supplemental documents anticipated in FY 1987. Unreasonable staff reductions were a principal cause of recent failures. Staff completing one-time assignments should be redirected to other work and by no means reduced.

2 NTEU addition would permit closing 316,000 more taxpayer delinquent accounts per year than the Administration's program. This would result in collecting additional revenue of \$570 million annually.

3 NTEU program would permit assisting 50 million taxpayers, 5 million more than the Administration's program.



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MAY 13 1986

Ways and Means
Subcommittee on Oversight

May 1, 1986

The Honorable J. J. Pickle
242 Cannon House Office Bldg.
Washington, D.C. 20515

Dear Congressman Pickle:

We appreciate your interest in NTEU's recommendations for IRS over the next five years, which include both stronger enforcement, improved taxpayer services, and a tax penalty amnesty to bring non-filers and underreporters into compliance. We believe that, in order to halt the fall in voluntary compliance and reap the large additional revenues that accrue from increasing the overall compliance rate, strengthened enforcement and a one-time tax penalty amnesty would be mutually reinforcing and offer the best prospects of success in the near term.

The basic rationale for the program is that, since IRS knows (or has the capability of knowing, through the information returns system) who the non-filers and underreporters are, but will never have sufficient enforcement resources to deal with every taxpayer who is noncompliant, it behooves the Federal government to take decisive steps to bring the maximum number of taxpayers into voluntary compliance as rapidly as possible. We believe NTEU's program would accomplish this.

In order to set forth the broad outlines of this program, we have prepared a Five-Year Plan for IRS for the period FY 1987-91. The plan specifies the additional resources required to significantly strengthen compliance-related activities in Examination, Collection, and Taxpayer Services. Our program differs from the President's program which would add 2,500 positions to Examination in each of the next three years. The President's program is not adequate to stem the fall in compliance, as is evident from IRS' forecast that the tax gap will rise from \$92 billion in FY 1986 to \$159 billion in FY 1991.

Table 1 presents a forecast of tax receipts and compliance if there is no change in current policies and present trends are allowed to continue. Based on CBO's projection of income tax receipts and IRS' forecast of the tax gap, it is evident that the overall compliance rate will fall from the present level of 81.6 percent to 80.5 percent by 1991. The composition of the tax gap shows that large gains are possible by bringing noncompliant taxpayers, particularly nonfilers and underreporters, into compliance. These groups would be targets of the amnesty program, under which non-filers would have an opportunity to regularize their status without penalty, and underreporters would be able to report and pay taxes plus interest on omitted income (or run the risk of increased penalty by failing to do so).

Table 2 shows the planned allocation of additional resources under the President's program and NTEU's 5-year plan. NTEU's program adds 10,000 average positions for Examination, 4,000 for Collection, and 1,500 for Taxpayer Service during FY 1987-91. Our program is 2,000 positions larger than the President's in FY 1987, and 3,000 positions larger in FY 1988 and FY 1989. These additional positions would be retained in FY 1990-91 and future years, depending upon progress being made toward compliance objectives.

We believe that by raising audit coverage and collection, and providing more responsive and available assistance to taxpayers, NTEU's program offers a realistic prospect of stabilizing the voluntary compliance rate at the current level of 81.6 percent, while laying the foundation for raising this rate in succeeding years. In order to bring about a decisive reversal of the trend in compliance, NTEU would combine its program of strengthened enforcement and taxpayer assistance with a one-time tax penalty amnesty which would forgive both civil and criminal penalties during the amnesty period on condition of payment of all taxes plus interest legally due.

By directing the amnesty at the large population of nonfilers and underreporters (most of whom are known through document matching), we believe it would be possible to achieve an increase in the compliance rate, though how much of an increase will occur is difficult to predict. We can, however, estimate for different changes in the compliance rate what the revenue yield to the Treasury would be. Our estimates show that for even a small change in compliance, the revenue gained would be substantial.

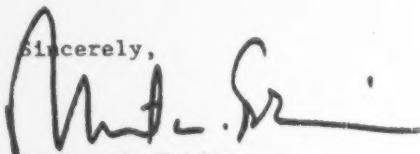
Table 3 shows a forecast of revenue that can be anticipated from both direct enforcement and increased compliance resulting from the tax penalty amnesty. All told, additional direct enforcement revenues of \$35 billion would accrue over the five-year period, and another \$19 billion would be obtained if these enforcement efforts are strong enough -- as we believe they would be -- to stabilize the compliance rate at the current level.

Allowing adequate leadtime for both strengthened enforcement and necessary publicity, a tax penalty amnesty could be implemented in FY 1988. We have selected FY 1988 for planning purposes, but other years could be selected. The amount of revenue resulting from the amnesty would depend upon what happens to the compliance rate in FY 1988 and succeeding years. If the rate increases just one percent above the current level, we estimate that additional revenue of \$7 billion in FY 88 and \$48 billion over FY 1988-91 would result. Strong efforts would be made to maintain the compliance rate at the new level in the years following amnesty. If these efforts were successful, additional revenue of approximately \$83 billion could result from the combination of stronger enforcement and the amnesty program during the five-year period, FY 1987-1991.

NTEU believes that IRS should be required to submit each year a detailed five-year plan that forecasts the trend in compliance and the tax gap under current policies and programs, resource requirements to raise compliance toward an ultimate objective of 90 percent, cost of the necessary resources, and revenue return and other results anticipated if the additional resources are provided. We have drafted report language requiring preparation of such a plan, and are enclosing a copy for your information.

I appreciate the opportunity to bring NTEU's Five-Year Plan for IRS to your attention. Should you have any questions concerning this plan, my staff and I would be happy to assist you.

Sincerely,



Robert M. Tobias
National President

Enclosure

PS/prw/0245L

TABLE 1. FORECAST OF INCOME TAX RECEIPTS AND TAX GAP, FY 1987-1991,
ASSUMING NO CHANGE IN CURRENT POLICIES
(Billions of Dollars)

	1987	1988	1989	1990	1991
Income Tax Receipts (CBO Forecast)	473.9	522.0	568.7	612.9	656.9
Unreported Income of Individuals ¹	376	404	436	469	504
Income Tax Gap	106.9	118.8	132.2	145.6	159.0
<u>Consisting of Taxes Owed On:</u>					
Nonfiler Income	3.75	4.23	4.70	5.18	5.66
Underreporter Income	67.46	76.03	84.61	93.18	101.76
Overstated Deductions	17.33	19.53	21.73	23.94	26.14
Corporate Income ²	16.81	18.95	21.09	23.22	25.36
Income Tax Compliance Rate ³	81.6%	81.5%	81.1%	80.8%	80.5%

1. Legal-source income of filers and non-filers projected as percent of GNP, based on IRS, Income Tax Compliance Research data for 1981

2. Includes corporate tax gap plus employer underdeposit of withholding

3. Tax receipts divided by sum of tax receipts plus tax gap

TABLE 2: PLANNED RESOURCE ALLOCATION FOR IRS COMPLIANCE RELATED FUNCTIONS,
PRESIDENT'S PROGRAM AND NTEU'S PROGRAM, FY 1987-1991

	(Average Positions)			
	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>
New Positions Added:				<u>1991</u>
President's Program:				
Examination	+2,500	+2,500	+2,500	*
NTEU's Program:				
Examination	+2,500	+3,500	+4,000	*
Collection	+1,500	+1,500	+1,000	*
Taxpayer Service	+500	+500	+500	*

* No Planned Increase or Decrease in Positions

TABLE 3. FORECAST OF REVENUE FROM NTEU PROGRAM WITH AND WITHOUT TAX PENALTY AMNESTY IN FY 1988
(Billions of Dollars)

	1987	1988	1989	1990	1991	5-Year Period
<u>Without Tax Penalty Amnesty</u>						
Direct Enforcement Revenue						
Examination	1.717	4.121	6.520	6.520	6.520	25.398
Collection	.891	1.782	2.377	2.377	2.377	9.804
Sub-Total	2.608	5.903	8.897	8.897	8.897	35.202
Revenue from Stabilizing Compliance Rate ²	--	.900	3.234	6.036	8.874	19.044
<u>With Tax Penalty Amnesty in FY 1988</u>						
Direct Enforcement Revenue	2.608	5.903	8.897	8.897	8.897	35.202
Revenue from 1% Increase in Compliance Rate		7.3	10.243	13.621	17.033	48.197
Revenue from 2% Increase in Compliance Rate		13.7	17.252	21.206	25.192	77.350
Revenue from 3% Increase in Compliance Rate		20.1	24.261	28.791	33.351	106.503
Revenue from 5% Increase in Compliance Rate		32.9	38.279	43.961	49.669	164.809
Total Revenue with 1% Incr. in Comp. Rate	2.608	13.203	19.140	22.518	25.930	83.399
Total Revenue with 2% Incr. in Comp. Rate	2.608	19.603	26.149	30.103	34.089	112.552
Total Revenue with 3% Incr. in Comp. Rate	2.608	26.003	33.158	37.688	42.248	141.705
Total Revenue with 5% Incr. in Comp. Rate	2.608	38.803	47.136	52.858	58.566	200.011

1. Assessments from examinations, plus collections. Assessments result in tax receipts in the current fiscal year and two succeeding fiscal years. Incremental returns used to forecast revenues are those used in recent IRS budgets, namely 18:1 for Examination (reduced to 14.5:1 in 1989) and 19:1 for Collection.

2. Voluntary compliance rate assumed to hold at current rate of 81.6%.

TABLE 4. COST OF RESOURCES FOR NTEU PROGRAM
(Millions of Dollars)

	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>5-Year Period</u>
Examination	94.4	226.6	377.6	377.6	377.6	1454
Collection	46.9	93.8	125.1	125.1	125.1	516
Taxpayer Service	15.6	31.2	46.8	46.8	46.8	187
TOTAL	156.9	351.6	549.5	549.5	549.5	2157

SOURCE: IRS BUDGET DATA

Proposed Report LanguageIRS Five-Year Plan

The Committee believes that, in order to properly allocate resources, the Service should prepare a five-year plan aimed at reducing the tax gap, increasing the level of voluntary compliance among taxpayers, dealing with special compliance problems such as abusive tax shelters and overseas tax havens, ensuring an effective level of taxpayer services, and maintaining balance among functional programs to prevent emergence of backlogs such as those now existing in Appeals, regulations, and taxpayer delinquent investigations. The first five-year plan should be submitted to the Committee on Appropriations of the House and Senate not later than October 1, 1986 and should cover the period FY 1987 through FY 1991. Thereafter, the plan should be updated annually and submitted with the budget justification for each fiscal year. The plan should contain, as a minimum, the following information for each fiscal year included:

- a. a forecast of the legal-source income tax gap, voluntary compliance percentage, and audit coverage under current policies and programs reflected in the President's budget;
- b. how the Service would allocate additional increments of 2,500, 5,000, and 7,500 average positions above the President's program, together with the revenue return and/or performance anticipated therefrom, and a projection of the tax gap, audit coverage and voluntary compliance percentage under each scenario of additional resources;
- c. a statement of resource requirements and their allocation aimed at raising the level of voluntary compliance toward an ultimate objective (which does not have to be within the five-year time span) of 90 percent, together with the revenue return or performance, and projection of tax gap, compliance percentage, and audit coverage for this scenario of resources;
- d. a statement of resource requirements and their allocation to deal with special compliance problems, such as tax shelters and overseas tax havens, and the revenue return or performance anticipated therefrom;
- e. a statement of resource requirements and their allocation to deal with additional workload created by tax law changes or new missions enacted by Congress, together with revenue return or performance anticipated therefrom.

Chairman PICKLE. Mr. Calkins.

**STATEMENT OF HUGH CALKINS, CHAIRMAN, SECTION OF
TAXATION, AMERICAN BAR ASSOCIATION**

Mr. CALKINS. Thank you, Mr. Chairman.

I have devised a few charts which will help.

If I may, I would like to start with the chairman's comments about fairness and with Mr. Schulze's question about what is the standard by which you can measure performance of the Internal Revenue Service.

Both questions are really answered by this chart, which only portrays graphically what has been talked about all morning, namely, that the tax gap, the billions of dollars that we are not collecting from the legal sector—this has nothing to do with the drug trade and the rest—the legal sector, has gone up from \$39 billion in 1976, to \$82 billion in 1981. My figures do not go any further because I do not think we have reliable figures that go further than 1981.

Chairman PICKLE. Your \$82 billion does not include drug trafficking and money laundering?

Mr. CALKINS. It does not. My understanding is that is another \$20 billion or so, although I think if our information is shaky with the legal gap, it is even shakier with the illegal gap.

On the other hand, if you look at the audit coverage, it was 2.6 percent in 1979 and it is now down to 1.1 percent estimated for 1986. In my view, this is a serious indictment of the fairness of the U.S. Government. I pay my taxes, and frankly I resent the fact that I am paying nearly 20 percent more than I would have to pay if everybody else were paying their share of the taxes, or if the U.S. Government were enforcing the laws that are in place.

I would suggest, Mr. Schulze, that the objective to be achieved can easily be stated in terms of getting this compliance percentage up. A reasonable objective is to get it up to 90 percent by the tax filing year of 1996. As Jerry Kurtz said, there is a measurement period you have to go through. So we won't know whether we have achieved that objective in 1996 until 1999 or some such year. Still, it is a reasonable objective for the Congress and the administration to state that, by 1996, we will be collecting 90 percent of the taxes that people in this country owe.

I am not as influenced as some others are by whether the trend line continued to be down beyond 1981. I think it may very well level off. The reason it will level off is not because we are doing better in these face to face meetings former Commissioner Kurtz says are so important—I agree with him on that. It is because there are offsetting factors that help.

The principal offsetting factor is the ability of the Internal Revenue Service to use computers to match names. IRS capability in that area has gone up substantially. We are collecting a good deal more of the dividends and interest which back in 1976 or 1979 we were not collecting. For that reason, I think our objective should be, not simply to get back to the percentage we were at in 1976, but to do substantially better and get up to a 90-percent collection level.

Nobody thinks we should get to 100 percent. The ABA resolution, which was passed a few months ago, supporting increased resources for the Internal Revenue Service, made the point that the Internal Revenue Service should be conducted without undue intrusiveness. It should not be going after every last dollar. Still, there is a reasonable target to be set. I urge, Mr. Chairman, that this committee urge the Congress to set the target, and then ask, not the Internal Revenue Service, but the administration as a whole, in fact, the U.S. Government as a whole, for a plan for achieving that objective.

I do not think the Internal Revenue Service can do it by itself. Simply giving the Internal Revenue Service more money and more people, under present circumstances, will not solve the problem. It is necessary to address Federal personnel policies and other problems of the U.S. Government outside of the Internal Revenue Service in order to permit good management practices to be applied within the Internal Revenue Service.

To illustrate the problem with Federal personnel practices, we obtained data showing that a revenue agent, newly hired, at the bottom of the seniority list, is paid, on the average throughout the United States, 10 percent less than is paid to an accounting graduate of a college going directly into an accounting firm.

Now, that is a nationwide average figure. Internal Revenue Service concentrates its resources in those places where there is the biggest problem. I am told that at least 10 percent of all revenue agents in the United States are in Los Angeles County. If you look at the gap in Los Angeles County between what revenue agents are paid and what the accounting firms are paying to their new hires, I am sure the gap would be very much bigger than 10 percent.

In the case of a computer programmer, we found that the starting pay for a person newly hired by the Internal Revenue Service is \$14,390. In private industry, we are told, the range is \$20,000 to \$28,000. At \$20,000, the IRS is trying to hire competent people when their pay scale is 30 percent below the going rate, and at \$28,000, 50 percent below the going rate.

We do not need to increase the compensation of all revenue agents to the level which is necessary to get some revenue agents who are capable of understanding complicated corporate returns or complex tax shelters with 90-page circulars and tax attributes sections 8 or 10 pages long. What we need, is differentiation among revenue agents. I am not sure Mr. Tobias would agree with this, but in some fashion there must be a way in which the IRS can hire a reasonable share of people who are just as bright and just as resolute as the people employed by the investment bankers, accounting firms, law firms, investors, and private industry. Only if the quality of some of the people at the rank and file level in the IRS can be improved can IRS do something significant about the compliance gap.

The quality of the people at the top in the IRS is extraordinarily good on the whole. But when you get further down in the list, every practitioner knows that there are serious quality problems reflected in the performance of the IRS. My most recent example came about as a result of the changes in ERISA that went into effect at the end of the year. My firm had to review the ERISA

plans for many companies acquired by our clients in the last few years. We found that, in general, the worse the plan was, the more likely it was to have been approved quickly, readily and easily by the IRS. Presumably, the revenue agents reviewing a very poorly drafted plan didn't know enough about the general principles of ERISA to know what to do with a plan that was very bad. When the plans were better, they had a much more careful scrutiny by the IRS people. Apparently, it is easier to nit-pick a plan which is good than to cope with a plan which is totally out of compliance.

The next chart illustrates its turnover problem. Many of the employees of the Internal Revenue Service are temporary. They are hired for the filing system in the spring. In the service centers, about three times as many are temporary as are permanent. In 1984, on a nationwide basis, 45 percent of temporaries were new. In 1986, 61 percent were new. This is another illustration of the problems resulting from inadequate compensation or inadequate morale.

At the Austin, TX, Service Center, 81 percent of the temporary employees in 1984 were new. They had no prior IRS experience and had to be trained from scratch to handle the filings in that season. In 1986, that 81 percent has gone up to 91 percent. Only 9 percent of the people who were temporary employees in Austin in 1985 came back to work for the IRS in 1986. That suggests that something is seriously wrong.

Chairman PICKLE. I had understood that over half the people had been there less than 1 year's time. You are saying it is not over half, it is 90 percent—is that what you are saying to me?

Mr. CALKINS. I am saying in the case of temporary employees, that being the only statistic we were able to get, 91 percent of the temporary employees hired this year in Austin, TX, were new. Only 9 percent had prior experience last year or the year before that. The chart shows a very, very high turnover.

Chairman PICKLE. That is true of most of the IRS centers. That may be higher in Austin—

Mr. CALKINS. Austin fortunately is the highest. The average shown up here, 61 percent—

Chairman PICKLE. What do you mean fortunately is the highest?

Mr. CALKINS. Only in the sense other service centers don't have that serious a problem.

Chairman PICKLE. What about Philadelphia?

Mr. CALKINS. I don't know—

Chairman PICKLE. I hope your next chart compares Philadelphia.

Mr. CALKINS. The next chart deals with what little we know about what happens when you ask the IRS to carry out nontax functions, but it does raise disturbing questions. This study was done by the IRS back in 1981 and 1982. A control group was established, and a so-called offset group. The offset group are the group as to whom there was a family child support offset to the tax refund in the prior year.

What this chart shows is that in the control group, 12 percent of those who had a refund in the prior year didn't file a return in 1982. This may have been for very good reasons, such as that their income dropped and they weren't required to file a return. In the offset group, those from whom there was a set off because they

owed family support money, the 12 percent goes up to 24 percent. If you look at a slightly more difficult concept, which is what happened in 1981 and 1982, again between a control group and an offset group, measuring the percentages of those who had refunds in 1981, who became balance-due taxpayers or taxpayer delinquent account taxpayers in 1982, you again see the same pattern.

In the nonoffset group, the people who received refund claims in 1981, without offset, $2\frac{1}{4}$ percent became balance-due taxpayers. That means that IRS sends at least one notice to them to try to collect the tax. One percent became taxpayer delinquent accounts, which means that after four notices, the account is referred to the IRS Collections Branch for collection. In the offset group, those from whom support payments were withheld, the $2\frac{1}{4}$ percent goes up to 4 percent, and the 1 percent goes up to about $2\frac{3}{4}$ percent.

Now, this is an IRS study, and it comes with a good many qualifications as to how much weight can be based upon it. In particular, it is based only on the child support responsibility that was given to IRS; therefore, it does not really tell us anything about the student loan responsibility or some of the other responsibilities that have been added. When you add together, however, the student loan population, the child support population and the others who are subject to the new responsibilities which have been put on the IRS, you get collectively a very substantial number of taxpayers. This report suggests there is some evidence to suppose that those taxpayers are going to go backwards in their compliance behavior the year following the Internal Revenue Service's acting as a bill collector as well as a tax collector.

I emphasize this is only a start of an inquiry that needs to be made, but I do think it is an important inquiry.

Now, the third element of outside trouble for the IRS is the budget. The preceding panel emphasized how much might be done if the U.S. Government could in some way provide the IRS with a budget that it could use during the year. The history is on the next chart.

In 1976, 1978 and 1980, the IRS had a budget before the year started. Since 1980, there has not been any year in which the IRS received a budget either before the year started or while the year was going on. In every year since 1980, the IRS has functioned on a continuing resolution throughout the entire year.

Now, Mr. Schulze or Mr. Dorgan asked about business behavior within the IRS. I suggest that it is an elementary principle of sound business behavior that an enterprise which is only collecting 80 percent of what it is supposed to collect should at least have a budget before the budget year starts. Yet, that has not been the case with the IRS since 1980. There is a popular pastime these days of dumping on the IRS. A lot of taxpayers do it when something goes wrong, the computer doesn't respond clearly, they get the wrong kind of form, or they can't understand a form. So they write a letter to their Congressman and vent their anger. I can understand that.

I received a 90-day letter the other day, which means I was on the way to Tax Court, because I was 5 days late in getting in one of my installment payments. It was not a big problem for me, because I knew what to do when an error occurs; but a taxpayer that

doesn't know what to do is likely to be frustrated and write his Congressman.

I urge, however, that this subcommittee refrain from the easy practice of saying it is all the IRS' fault. "If IRS only had better practices." "Why don't you do it right the first time." The problem goes beyond the IRS, to the whole U.S. Government. When in the whole history of tax collections has the head of the U.S. Government; namely, the President, ever concerned himself with the fact that—back to my first chart—20 percent of the taxes that people ought to pay, are not being paid? That really is a scandalous unfairness; and yet it attracts almost no attention in the highest reaches of the U.S. Government. It clearly should if we are going to do anything about the problem.

My final point simply relates to matters within the Internal Revenue Service. It is clear the collection problem which is portrayed in this chart is a critically serious one. The accounts receivable which were \$8.2 billion in 1977 were \$34.5 billion in 1984 and are now \$45 billion at the end of 1985. Yet, as has been pointed out, IRS in 1985 employed 2,000 fewer people in that activity than in 1984, and the 1986 budget extends 1985 into 1986. It is true—I see that Mr. Persky is still here—that putting more people into collections is fairly low on the wish list of the IRS. If IRS got even more money than is in their budget request, collections hasn't made it out of the wish list and into the "we have got to have it" category. Even in the wish list, IRS is only asking to get back 1,500 of those 2,000 places. So collections is clearly a problem.

Chairman PICKLE. Thank you. Your entire statement will be included in the record. We appreciate your testimony and the charts you supplied the committee.

[The statement of Hugh Calkins follows:]

STATEMENT OF HUGH CALKINS
ON BEHALF OF THE AMERICAN BAR ASSOCIATION
BEFORE THE SUBCOMMITTEE ON OVERSIGHT
U.S. HOUSE OF REPRESENTATIVES
CONCERNING THE ADMINISTRATION'S FISCAL
YEAR 1987 BUDGET PROPOSALS RELATING
TO THE INTERNAL REVENUE SERVICE
MAY 12, 1986

Mr. Chairman and Members of the Subcommittee:

Introduction

I am Hugh Calkins, Cleveland, Ohio, Chairman of the Section of Taxation of the American Bar Association. I appear here today at the request of William W. Falsgraf, President of the American Bar Association, to express the view of the Association with respect to the Administration's proposed fiscal year 1987 appropriations to the Internal Revenue Service. The 300,000 members of the American Bar Association have long been concerned with the efficient and effective operation of the IRS and the 30,000 members of the Section of Taxation are deeply concerned with these issues. At its midyear meeting only three months ago, the Board of Governors and House of Delegates of the Association, upon the recommendation of the Section of Taxation, adopted a resolution urging that the Congress provide adequate funding and personnel to assure quality performance by the IRS without undue intrusiveness, and with due regard to efficiency in its operations.

This testimony does not attempt to address specific line items of the IRS budget. We are, instead, addressing what we perceive to be major resource and structural problems with the IRS budget and the outside constraints on its operations and are suggesting approaches to deal with these issues.

Revenue Initiative

In its fiscal year 1987 budget, the IRS is requesting a revenue initiative -- the addition of 2,500 examination staff years per year for three consecutive years. The Service estimates that these added staff years will produce a revenue gain of \$10.3 billion through fiscal year 1991. The proposal recently approved by the Senate Finance Committee also contains a welcome commitment to additional funding. We support wholeheartedly the concept of revenue initiative. Indeed, as appears below, we believe that the entire IRS budget should be viewed as a "revenue initiative."

However, we recommend that revenue initiatives requesting additional enforcement resources be balanced. The additional resources should be distributed among all revenue

producing programs, including appeals, delinquent returns and collection of accounts receivable as well as examination.

For example, as I discuss in more detail below, although the accounts receivable balance is approaching \$50 billion, collection resources have dropped off precipitously. Overall staffing in collection declined by more than 2,000 positions from fiscal 1985 to fiscal 1986, and under the proposed budget the reduced collection resource level for fiscal 1986 is being continued without change through 1987. It would be both ironic and counterproductive if the planned increased audit activity failed to produce real dollars for the Treasury because it made the already serious collection problem worse.

Similarly, increased examination activity makes increased appeals activity a few years later a certainty. Unless IRS revenue initiatives are balanced, we run the risk of trading one form of inadequate IRS capacity for another form of inadequate capacity.

Setting Compliance Objectives

Since 1964, the IRS has regularly measured compliance by comprehensive audits based upon statistical samples of filed returns. This program has not measured compliance of those who do not file returns, and does not fully measure income omitted on filed returns, especially income which is difficult to discover.

In 1983, the Service released a careful and thorough study of income tax compliance which estimated that for 1976 taxpayers failed to pay \$34.6 billion of income tax due on income from legal sources and that 83% of taxes due from taxpayers on income from legal sources was paid.

The Service's own estimates and those made by industry researchers indicate that compliance has continued to decline. The same 1983 Service statistics indicated that by 1981 the compliance rate was only 81% and that the tax gap from legal income sources had grown to \$82 billion, while audit coverage had declined to 1.8%. Stated otherwise, the compliance rate had decreased in the 5 years from 1976 to 1981 (See chart 1).

Mr. Chairman, both the magnitude of the compliance gap in 1981, and the fact that we do not have a comparable estimate of how great it is today, should be of great concern to this committee and to every citizen concerned that he or she pay a fair share, but not more than a fair share, of the cost of the Government of the United States.

A number of studies are being carried on by the IRS and under private auspices intended to shed light on the magnitude of the compliance gap and its distribution among industries, geographical areas, income levels, and categories of income or expenses. I am personally participating in two of those studies. One is a multi-year project conducted by the American Bar Foundation, with financial support from foundations, corporations, law firms, the ABA Tax Section and other sources. A second is a short-term project conducted by the American Enterprise Institute and funded jointly by a foundation in Cleveland Ohio, the ABA Tax Section and the AICPA, which seeks to determine the ratio between a dollar more, or a dollar less, of resources made available to the IRS, and the collections of the Treasury from the income tax system.

All of those who participate in these private studies are struck by the fact that, although the federal income tax compliance gap represents a substantial portion of the annual deficit in the budget of the Federal Government, there is no known strategy or plan for closing the gap. No objectives are set by the United States Congress or by the President. Surely, in any private business 1 percent as large as the Federal Government, a gap between the receipts to which the enterprise was legally entitled and the receipts which the enterprise in fact collected, only a small fraction as large as the 20 percent gap suggested by chart 1, would call for immediate action. Objectives would be set together with specific dollar goals and timetable. A plan would be designed to which substantial resources would be devoted. The most talented people in the organization would be put to work to solve what would be perceived to be a major problem.

Not so with the compliance gap with the United States Government.

To the best of my recollection, no President has ever even referred to the fact that his Administration is failing to collect 20 percent of the dollars which citizens owe, and thus is unfairly imposing on law-abiding citizens a larger tax burden than they would have to bear if their fellow citizens paid what they owed. So far as I am aware, no subcommittee chairman, no committee chairman, nor member of either House of Congress has attempted to build a political career on the virtually undeniable fact that the law-abiding citizens of the United States are being required to pay substantially more in federal income taxes than they would have to pay if other citizens were law-abiding or if the IRS were able to carry out its job without slippage.

Of course, no one expects that the IRS would or should have the resources necessary to collect every last dollar that is owed. The American Bar Association resolution calls for resources large enough to assure effective performance "without excessive intrusiveness". Those who are concerned about income tax compliance do not seek perfection. We only seek a sufficient level of compliance to maintain the relationship of trust and confidence which ought to exist between law-abiding citizens and their government.

Citizens who are concerned about fairness in our society have a right to expect that the United States Government will make every reasonable effort to treat its citizens fairly. Fairness in tax matters means a reasonable assurance that citizens cannot get away without fulfilling their obligations. An audit coverage level which in one decade has declined from 2.6 percent of returns filed to a projected 1.1 percent of returns filed is, in my view, a clear breach of the obligation which the United States Government owes to its citizens to be fair.

To implement the recommendation of the American Bar Association, its Tax Section respectfully suggests to this subcommittee, charged with oversight of the Internal Revenue Service, that it establish a clear objective that fairness be restored to the tax system, through improved compliance, by measurable and measured steps in the next decade. The advent of computer resources permits a compliance level much higher than the 83.3 percent estimated for 1976. Surely, it would not be an unreasonable objective that by 1996 at least 90 percent of the income taxes owed with respect to legal activities would be actually collected by the United States Government.

If that objective could be established, it would then be necessary to formulate a plan for achieving the objective. That plan cannot be limited to the IRS alone. It must include the Treasury Department, the Office of Management and Budget, the White House and the United States Congress. The plan should be written, published for discussion, debated, refined, approved and implemented. When that has been done, an appropriate budget for the IRS can be established for each of the years of the decade.

We believe that formulating a plan, and providing the resources to carry out the plan, are the two most critical steps to restore fairness to the income tax system. As the balance of my testimony will show, however, there are other constraints on the effective operation of the Internal Revenue Service which make no sense, which are within the control of Congress, and which should be removed. With your permission, Mr. Chairman, I would now like to turn to them.

IRS Personnel

Since the IRS is a service industry, the place to start in any exploration of its performance is with its personnel. The ABA Tax Section believes that the staffing of the IRS presents serious problems which the Congress should address.

A major expansion and change in the American economy has occurred over the past ten years. There has been a large increase in the number of corporate returns and the number of "complex" personal returns. Specialized investment vehicles such as large limited partnerships, REITS, and RICS, and new investment mediums, such as index futures and mortgage pools, have proliferated. Enactment of either of the tax reform measures now before the Congress will not substantially relieve these complexities. To the complexities of the economy, there has been added an unprecedented level of Code revision.

To cope with these mounting administrative problems, the IRS should have recruited and retained a larger number of capable people, able to understand the new complexities and to adapt to a constantly changing administrative environment. The experience of most tax practitioners tells us that such recruitment and retention has not occurred. Instead, tax practitioners find that altogether too many examining agents are unable to comprehend the documents which they are expected to understand, and unable to interpret correctly detailed provisions of the Code and the regulations.

A single illustration drawn from the recent experience of my own firm will have to suffice. In connection with our review of ERISA plans of subsidiaries acquired by our clients in recent years, our ERISA practitioners found that plans which were clearly not in compliance, and which made very little sense, had been approved by IRS personnel. On the other hand, plans drafted with much more care and clarity received a much more time consuming scrutiny, apparently because they were understandable and therefore could be criticized with less understanding of the fundamental requirements of the law.

There are two basic federal employment regulatory problems. One is that IRS often cannot hire until so late in the year that the better accounting graduates are already placed with private employers. Second, starting revenue agents are paid at average levels about 10 percent below the levels at

accounting and business firms, and at level in larger cities which are much more than 10 percent below the private industry scale. New IRS data processing programmers start at \$14,390, while the average private industry comparable pay scale is \$20,000 to \$28,000.

The difficulties of the IRS with initial recruitment are compounded by the rate of turnover of its employees and by the increasing percentage of the employees of IRS service centers represented by seasonal work force. We have identified figures, displayed on Chart 2, which show that the percentage of the total seasonal workforce of the IRS which is represented by new employees, with no prior IRS experience, has risen dramatically in the last two years. In the Austin Service Center, which fortunately is not typical of the average center, over 91 percent of seasonal personnel were new for the 1986 filing.

No agency or business, and least of all an agency with as much impact on the public as the IRS, can afford such high employee turnover and hope to function efficiently.

While we have not been able to develop precise figures, our experience leads us to believe that the rate of turnover of IRS employees at most levels has been increasing in recent years. Although turnover of staff at district offices, including revenue agents, special agents, revenue officers, and taxpayer assistance staff, may not be statistically as large as in service centers, it can be even more serious. From the standpoint of assuring voluntary compliance, a poorly conducted audit may be worse than no audit at all. Taxpayers come away from such an audit with an attitude that they can beat the tax system. Similarly, a taxpayer given a wrong answer or inconsistent answers to his tax questions by the IRS Taxpayer Service develops a low perception of the IRS. If it is unable to understand the law, how can it enforce it?

To make an appreciable difference in the quantity and quality of IRS efforts, the IRS needs substantially more resources. It also needs innovative approaches within the federal personnel system. Some of the recent proposals along these lines -- including President Reagan's pay-for-performance proposal and Representative Oakar's bill for testing of alternative pay systems -- may be the way to go. The Congress might seriously consider picking the IRS or one IRS region or districts as among the first agencies for the testing of these innovative proposals.

Taking a longer range view, it may be time to revisit the issue whether the IRS should centralize so much of its operations in ten large service centers. When a breakdown occurs at one of these centers, whether because of personnel errors, equipment malfunctions or other problems, the results are serious, as we witnessed in Philadelphia during the 1985 filing season. The solution may be to decentralize these operations more through the country. Personnel problems would be alleviated because the IRS would not be competing for such large numbers of employees in concentrated areas. In addition, taxpayers would feel that they were dealing with people close to home rather than with a depersonalized and remote computer center.

Quality Assurance

Every large enterprise needs to focus on assuring the quality of its performance. In recent years, the IRS has been focusing on the development of backup systems which take effect when there are real or apparent deficiencies in the quality of the initial performance.

The Problem Resolution Program was established nationwide in 1977 in recognition that taxpayers had problems that were not in all instances adequately resolved by front-line Service functions, and needed some place to go for help. Two years later, in 1979, a taxpayer Ombudsman was established to provide the taxpaying public with its own advocate and elevate the program to greater visibility and influence in solving individual taxpayer problems and identifying underlying systemic problems. In fiscal year 1979, the Problem Resolution Program counted total case receipts of 79,234. For fiscal year 1985, that number was 506,976.

The Problem Resolution Program is not a substitute for quality review and control that is built into the functions, programs, and processes at an earlier point when the work is being done. The objective is prevention or earlier detection of errors. At least until the recommendations for budget reform referred to below are enacted, we suggest that quality assurance be internalized in the Service's budget as a separate line item in each of the major functions including the processing of returns, the audit of returns, the investigation of criminal cases, the collection of accounts receivable, and taxpayer service. IRS' performance in carrying out these activities should be separately monitored.

In suggesting that the IRS needs a specific funding for these quality enhancement programs, I do not mean to ignore the reputation which the IRS justifiably earned for many years as being one of the most effective administrative agencies of the U. S. Government. It is an unfortunate fact that this reputation has in recent years been tarnished by well publicized episodes of significant breakdown and by the discovery by many citizens in their personal dealings with the IRS that it is not as effective as it had been cracked up to be. The provision by Congress of funds specifically directed to providing quality assurance in each of the major programs of the IRS would communicate a message that will enhance the respect and goodwill which taxpayers must feel toward the tax system and those who administer it if the serious decline in self-assessment is to be reversed.

Collection of Accounts Receivable

IRS statistics show that between the fourth quarter of 1983 and the fourth quarter of 1985, the dollar value of outstanding accounts receivable rose from \$24.9 billion to \$45.0 billion. See Chart 3. In the short interval of two years, therefore, tax debts owed the IRS have increased more than 86 percent, an increase unparalleled in both absolute and comparative terms in recent tax administration history. Although the automated collection system ("ACS") has improved the ability of the IRS to collect its accounts receivable, ACS alone is clearly not enough.

The increase in accounts receivable is disturbing from a number of standpoints. First, and most obvious, is the adverse

effect it has on the national deficit. The members of this subcommittee do not need me to tell them how collection of even one half of the present outstanding accounts receivable -- or \$22.5 billion -- would improve the overall budget picture, or how difficult it is for Congress and the President to agree on either spending reductions or tax increases that would produce an amount of that magnitude.

Second, the recent increase in IRS receivables suggests that some business taxpayers may be using the IRS as a short-term lender willing to advance funds at about the prime rate to borrowers whose shaky credit would require a much higher rate in the commercial market. The absence of sufficient IRS collection resources to enforce timely payment of tax debts surely contributes to this "government financing" opportunity.

Moreover, the inability of the IRS to enforce promptly payment of accounts receivable reduces the credibility of the rest of the tax system. When audits or other enforcement contacts result in tax deficiencies, and those deficiencies are then allowed to remain uncollected, the deterrent effect of the initial enforcement contact is greatly reduced.

IRS data indicate that resources applied to the collection of accounts receivable show a return of more than \$17 for every dollar spent. Even if this ratio turns out to be too high, by any measure increased collection resources will produce a big return for each dollar invested.

IRS Performance of Non-Tax Administration Functions

Beginning in 1981 the Internal Revenue Service was required by statute to collect debts for delinquent child support payments. This was the first time the IRS had the responsibility for collecting debts of other government agencies. Now, in addition to child support payments, the IRS is responsible for collection of delinquent loans owed the Department of Education (student loans), the Veterans Administration, the Small Business Administration, Housing and Urban Development and the Department of Agriculture.

The agencies involved reimburse the IRS for the cost of collecting their debts. The present situation, therefore, does not pose a direct resource problem for the IRS. However, performance of such non-tax administration functions may contribute significantly, although indirectly, to the IRS performance and resource problems, by causing taxpayers to change their tax behavior and become less compliant in order to avoid the IRS's collection efforts on behalf of other agencies.

There is evidence from a 1984 Service study that taxpayers who were the subject of refund offsets for delinquent support payments subsequently changed their tax behavior for the worse. For example, they tended to become non-filers or end up as delinquent collection accounts more often than would have been expected had the IRS not offset their refunds. See Chart 4.

So far as we are aware, there have as yet been no studies of the effect on voluntary compliance of the other bill-collecting responsibilities recently imposed on IRS.

The size of the taxpayer group whose compliance is potentially adversely affected is large. Deterioration in this group's compliance, therefore, could add substantially to the Service's enforcement workload and impair its performance. Given the concern that debt offsets will cause adverse changes in taxpayer behavior in our self-assessment tax system, and the fact that IRS resources are inadequate to collect tax debts already owed, Congress should ask these questions: Is it consistent with sound administration of our tax system to have the government's tax collector become the government's bill collector? Do the economies achieved outweigh the damage to tax compliance?

Biennial Budgets and Separate Treasury Appropriations

The administration of the tax system, a difficult and demanding job under the best of circumstances, is made even more demanding by the complexity and tardiness of the budget process.

The last time the Internal Revenue Service had an approved budget in place prior to the start of a fiscal year was 1976. The process has deteriorated during the intervening years to the point that since 1980, the IRS has "functioned" on the basis of continuing resolutions. See Chart 5. No responsible business and few units of state or local government would condone operating without a budget. The failure of Congress and the President to produce a timely budget fosters inefficiency, uncertainty and a lack of accountability among those responsible for achieving tax compliance goals and objectives.

The Internal Revenue Service is particularly affected by the inefficiencies resulting from the perennial delay in the annual budget cycle. The Service's budget is largely devoted to non-discretionary spending. Returns must be processed when received. Computer matches must result in inquiries to taxpayers in a time period that permits the accounts adjustment cycle to be completed before the next filing season. Examinations and collection activity must be commenced, at whatever level that activity is ultimately to be authorized, in a time period that permits completion of the examination and collection activities within the relevant statutes of limitation. Like the "Fram oil filter" commercial, a failure to take timely action may cause a much greater loss later, either in the form of costly corrective actions or in permanently foregone revenues.

In addition, the IRS budget must provide for purchasing and learning how to use computer equipment and systems capable of processing billions of pieces of paper and millions of electronic submissions.

A number of states use biennial budgeting without any loss of desirable legislative control over the direction of state agencies. The Brookings Institution's recently published "Economic Choices 1987" calls attention, at pages 111 to 126, to multi-year budgeting and its many benefits.

Congress should consider a biennial budget for all government agencies or, if that is impractical, for the IRS. If that suggestion is rejected, Congress should consider an annual budget for the IRS which is one year ahead.

This Subcommittee, as part of its oversight responsibility, may wish the IRS to conduct its own study and provide the subcommittee with the best information that is available estimating savings and program improvements to be expected from a biennial or a-year-in-advance budget.

The Subcommittee should also consider whether it would be advantageous to separate the appropriation for the Treasury Department from the appropriation for the Post Office. The Post Office has a large, politically strong constituency, and a reputation for overspending its budget. We understand that, when this occurs, other government entities within the same budgeting unit generally bear the principal brunt of the necessary reallocations of funds. Maintaining a steady and adequate financial base for the IRS is too important to place it at the risk of diversion of its funds to another major Department.

Thank you, Mr. Chairman, for this opportunity to present these views on behalf of The American Bar Association. The ABA and its Tax Section stand ready to provide any assistance within our capabilities to you in your consideration of these important subjects.

CHART 1 SETTING COMPLIANCE OBJECTIVES LEGAL SECTOR COMPLIANCE AND AUDIT COVERAGE			
	TAX GAP (BILLIONS OF DOLLARS)	COMPLIANCE (%)	AUDIT COVERAGE (%)
76	\$39	83.3	2.6
79	\$62	82.1	2.2
81	\$82	80.7	1.8
82			1.6
83			1.6
84			1.3
85			1.3
86			1.1

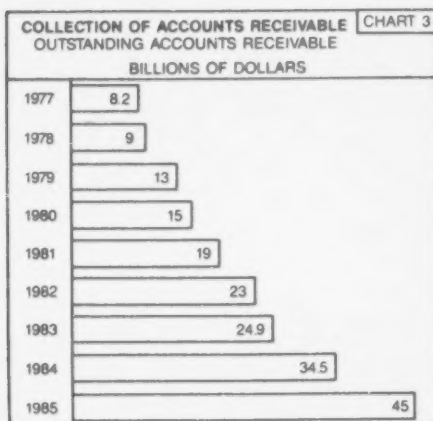
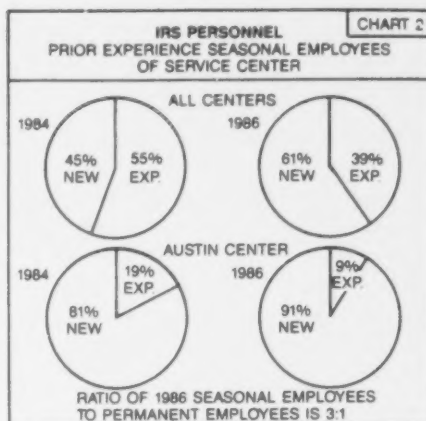


CHART 5
BIENNIAL BUDGETS
BUDGET HISTORY
1976-1986

	BUDGET APPROVED BEFORE START OF FISCAL YEAR	BUDGET APPROVED DURING THE FISCAL YEAR	CONTINUING RESOLUTIONS NO APPROVED BUDGET
76	YES		
77	NO	YES	
78	YES		
79	NO	YES	
80	YES		
81	NO	NO	YES
82	NO	NO	YES
83	NO	NO	YES
84	NO	NO	YES
85	NO	NO	YES
86	NO	NO	YES

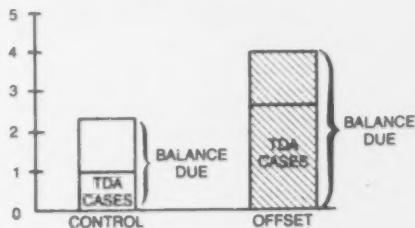
IRS PERFORMANCE OF NON-TAX ADMINISTRATION FUNCTIONS

CHART 4

PERCENTAGE OF TAXPAYERS
WITH 1981 REFUND OFFSET
WHO DID NOT FILE A 1982
RETURN



PERCENTAGE OF TAXPAYERS WITH 1981
REFUND OFFSET WHO REQUIRED A
NOTICE OF NON-PAYMENT ("BALANCE DUE")
OR FAILED TO PAY AFTER FOUR
NOTICES ("TAXPAYER DELINQUENT ACCOUNT")



Chairman PICKLE. Now Mr. Ellentuck.

STATEMENT OF ALBERT B. ELLENTUCK, CHAIRMAN, EXECUTIVE COMMITTEE, TAX DIVISION, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Mr. ELLENTUCK. Thank you, Mr. Chairman.

We are very much concerned that inadequate levels of funding for IRS could have a serious impact on IRS' operations. We are also concerned not only with the effect on operations but with the effect on the level of taxpayer confidence in the IRS and the effect on the revenue itself. We believe weakened IRS operations tend to erode the public confidence, which is essential to our self-assessment system of taxation.

In the areas of return processing, we have been very concerned with the widely publicized problems of the 1984 individual tax return filing season. We have worked with the IRS to help alleviate the situation. Although we believe the Service has done its best to try to correct the problems, we think the task remains an enormous one, and we believe it requires a substantial allocation of resources. The prompt and accurate processing of returns is critical for our entire self-assessment system.

Revenues can be increased without having to raise tax rates by enhancing the audit capability of the Service. The present examination rate of 1.2 percent of returns with a heavy concentration on tax shelters seems to us to be completely inadequate to seriously deter those who would play the audit lottery.

And, we find that it still takes our clients longer to receive a response from the IRS to written inquiries about their problems. This results from what the General Accounting Office calls excessive correspondence inventories. In other words, the IRS hasn't yet caught up in responding to taxpayer inquiries. To put it another way, the computers keep generating notices, keep tightening the screws on a taxpayer, and that taxpayer keeps writing and calling the IRS to correct their error, but no one at IRS is listening. This is extremely frustrating to the taxpaying public, and yet we find that this cycle goes on and on.

Statutory notices of deficiency are issued which can't be canceled, liens on wages and the taking of bank accounts are common. We think that that whole problem of excess correspondence inventories has to be faced.

In response to last year's publicity describing communication problems with the IRS, the AICPA formed a special working group to assist the IRS in this area, and we have made many recommendations which the IRS is considering.

We are also aware of the IRS' own taxpayer correspondence study. The objective of that study was to recommend corrective actions to improve timeliness and responsiveness to taxpayer correspondence. The IRS recommendations are excellent, and we wholeheartedly endorse them. But all the correspondence study recommendations have not yet been implemented at the local level, and the correspondence inventory that we talked about continues to plague the IRS.

We believe that both these problems are in a large part the result of inadequate resources for the IRS. And the increasing length of time for response is only one measure of the problem, and of taxpayers' frustration. When the tax law continues to change and become more and more complex, taxpayers must have responsive tax administration. Otherwise they are going to lose confidence in the system, and the American tradition of working within the system will be adversely affected.

Increasing budget allocations can, as you know, have a more direct revenue effect. It is widely recognized that tax revenue from under-reported income, the so-called tax gap, is a major, major problem. More and better enforcement is needed to begin, and I emphasize the word "begin," to reduce the size of this gap. There have been all kinds of estimates as to how much revenue the IRS could produce as a result of increased budget allocations. The AICPA Tax Division, together with the American Bar Association Tax Section, has started a project for development of an authoritative independent study to test the relationship between the IRS budget expenditures and additional revenue. This study has just gotten underway, and we have no conclusions yet, but it is obvious that at the present level of expenditures, additional allocations to IRS will more than pay for themselves in additional revenue for the Treasury.

To sum up my testimony, I would like to say that we know firsthand that the IRS is making a major effort to correct its problems and to improve its effectiveness in this area. However, we strongly believe that increased budget allocations will enhance these efforts, produce some very positive results, and have a beneficial impact on our tax system.

Thank you for the opportunity to present our views.

Chairman PICKLE. Thank you, Mr. Ellentuck.

[The statement of Albert B. Ellentuck follows:]

TESTIMONY OF

ALBERT B. ELLENTUCK

CHAIRMAN OF THE TAX DIVISION EXECUTIVE COMMITTEE
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Good morning. My name is Albert B. Ellentuck, and I am the Chairman of the Executive Committee of the Tax Division of the American Institute of Certified Public Accountants. The AICPA represents over 240,000 CPAs, many of whom work with the tax laws on a daily basis thus becoming intimate observers of the effects of the tax system on our nation and its taxpayers.

The AICPA has long been concerned that inappropriate levels of budget allocations to the IRS would have severe negative effects on IRS operations. These problems, however, not only affect the operations of the Service but also taxpayers perceptions of the IRS. As I'll discuss, it also has a revenue effect.

The IRS, GAO, and NTEU are all intimately familiar with IRS operations and have all stated that the resources available to the IRS are not sufficient. We agree.

Weakened IRS operations have served to erode the public confidence which is essential to our self-assessment system of taxation. In the area of returns processing, we have been very concerned with the widely publicized problems which accompanied the 1985 individual income tax return filing season, and have worked with the IRS to help alleviate the situation. Although we believe the Service has done its best to fix the problems under the circumstances, the task remains large and difficult and requires a substantial allocation of resources. The prompt and accurate processing of tax returns is fundamental to taxpayer trust in our system.

We believe our clients maintain a high level of compliance with the tax laws, and we believe that taxpayers who pay their fair share should not be required to shoulder the burden of those who do not. Revenues can be increased without having to raise tax rates simply by enhancing the audit capability of the Service. The present audit coverage rate of only 1.2% for individual income tax returns, with a concentration on returns which have substantial sheltered income, seems inadequate to seriously deter those who would play the "audit lottery". We believe statistics show that increased funding of the IRS examination function more than pays for itself through adjustments in returns which are examined. Moreover, the additional benefit in terms of unaudited compliance improvement and respect for the system cannot be measured.

We have found that it takes longer and longer to receive a response to a written inquiry regarding a taxpayer problem. This results from what the GAO calls "excessive correspondence inventories". What this means, practically speaking, is that before the IRS can respond to a taxpayer's inquiry about an IRS notice, a subsequent IRS notice is sent to the taxpayer.

This cycle goes on and on. We receive numerous complaints that often times, as part of this unnecessary cycle, bank accounts are attached, liens are placed on wages and statutory notices of deficiency are issued for taxes that aren't even owed. In the latter case, the IRS notice can't be rescinded, even if erroneously issued because the IRS doesn't have the statutory authority to do so. Taxpayers then proceed to file a petition in the Tax Court! All of this because of so called "excessive correspondence inventories".

In response to last year's publicity describing communication problems with the IRS, the AICPA formed a special working group to assist the IRS in this area. The AICPA is also aware of IRS' own efforts to cure the problems, most notably, the Taxpayer Correspondence Study. The objective of that study was "to recommend corrective actions to improve timeliness and responsiveness to taxpayer correspondence." The recommendations are excellent, and we wholeheartedly endorse their implementation.

All of the recommendations, however, have not been implemented at the local level. Why is this so? Why is the correspondence inventory so high? The answer, to a large degree, appears to us to be the lack of resources.

The increasing length of time for response is only one measure of the problem and frustration of taxpayers in this area. With an increasingly complex and ever changing tax law, when taxpayers have a problem, they must have a responsive tax administration. Otherwise, they will lose confidence in the system, and the American tradition of working within the system could be adversely affected.

I mentioned earlier that reduced budget allocations to the IRS not only affects operations but also taxpayer perceptions of the IRS. For example, correspondence backlogs affect taxpayer perceptions of the IRS which in turn affects voluntary compliance. Also, increasing the audit or examination coverage of tax returns will serve to raise the level of voluntary compliance.

Increasing budget allocations to IRS operations can also have a more direct revenue effect. It is widely recognized that tax revenue from underreported income (also referred to as the compliance gap, the underground economy or the hidden economy) is a major problem in the tax system. The so-called tax gap is enormous by anyone's estimate and is growing larger. More and better enforcement is needed to begin to reduce the size of this tax gap.

There have been various estimates as to how much revenue the IRS could produce as a result of increased budget allocations. The AICPA Tax Division, jointly with the ABA Tax Section, has undertaken a project for the development of an authoritative, independent study to test the relationship between IRS budget expenditures and additional revenues. That study is just beginning and we have no conclusions yet; but certainly there has always been a general belief in the tax community that at the present level of expenditures, additional expenditures will more than pay for themselves in additional revenue.

As I mentioned, the AICPA has been working closely with representatives of the Internal Revenue Service in an effort to develop technical and policy recommendations for the improvement of the Federal tax process on procedural and general administrative matters. And we know first hand that the Service is making a major effort to improve its effectiveness in these areas. However, we believe that increased budget allocations will enhance these efforts and produce some very positive results.

I appreciate the opportunity to appear before you today and would be glad to respond to any questions you might have.

Chairman PICKLE. Each of you gentlemen have given us a lot of valuable information, though not pleasant to hear. But I think there are things this committee sincerely needs to know.

I have two or three questions to ask. First, I would ask Mr. Finch, the GAO continues to be a constructive critic of the Internal Revenue Service's operations, and we appreciate your diligence in this field. Can you comment in general terms now what conditions are like today in the Internal Revenue Service service centers as it pertains to inventory levels? I asked that question earlier. What is the status of inventory levels with the IRS today?

Mr. FINCH. There are a couple or three points that relate to their present inventory levels and whether or not those levels will be down by the end of the fiscal year, which is what the budget figures are predicated on.

First, only 3 of the 10 IRS service centers had their unpostable inventories at manageable levels as of April 25, which was the most current data we could get. Only 3 of the 10. The national inventory is about 1.7 million cases, and the national inventory is down from last year by about 30 percent. Notwithstanding, 1.7 million cases is still in our opinion too many. Not only that, only 3 of the 10 centers are at the manageable level.

Second, only 1 of the 10 service centers had its adjustments-correspondence inventory at a manageable level as of April 25. The national inventory of 1.1 million cases is up 41 percent from the 1985 level. So things don't look good there either, sir.

The service centers have, in fact, been telling the national office that things look even worse, that with the projected workloads and—

Chairman PICKLE. Who has been telling you that?

Mr. FINCH. The service centers have been telling the IRS national office that the outlook for reducing the inventories doesn't look good. A couple of the reasons they give for this is that they have had a decline in production rates due to loss of skills through staff turnover, and I think Mr. Calkins presented an effective visual aid in that regard.

Chairman PICKLE. Let me ask Mr. Persky again. Did you hear the statement that the service centers—I am assuming in general—have notified the national office the inventories are high and will not come down? Is that correct?

Mr. PERSKY. Mr. Chairman, in looking at the 1987 budget, what we are doing now is reviewing what happened during the 1986 filing season. We expected to have more progress than we got. We are talking to the service center directors. Mr. Finch knows, in the review of the way we interrelate with field offices, there has been more and more contact this year. So we are in contact with those people. We are aware of the fact that they think the projections we originally made are too optimistic, and we are readjusting in accordance with that.

Chairman PICKLE. You are saying, in effect, the inventory levels will be "unmanageable"?

Mr. PERSKY. The inventory levels today are unacceptable, and we are not going to bring them down to acceptable levels as quickly as we wanted to.

Chairman PICKLE. Go ahead, Mr. Finch.

Mr. FINCH. I rest my case, sir.

Chairman PICKLE. What about the status of our computer equipment? Are they on order? Does each center have sufficient computer service?

Mr. FINCH. In terms of the capacity and the processors and that sort of thing to handle the workload now, yes, sir.

Chairman PICKLE. So with good luck we won't have a breakdown in the computer system?

Mr. FINCH. Not like we had in 1985. There is still the issue of the front-end processors and the capacity for them to take transactions, but a contract has been let to address that situation.

Chairman PICKLE. Mr. Tobias, you stated that the return processing should not be reduced by 2,700 positions at this time. You had recommended, I believe, to have as many as 4,700 new employees, is that correct?

Mr. TOBIAS. What I recommended, Mr. Chairman, and I think the colloquy that just preceded the question to me bears this out, the Internal Revenue Service shouldn't reduce returns processing by 2,700 positions, as proposed in the 1987 budget, and that it should remain at the status quo rather than reduce the number of positions. The 4,300 that we are recommending be increased are in areas other than returns processing.

Chairman PICKLE. Well, you are telling me, in effect, then, that the correspondence and the processing backlogs will not be cleared up this year based on your budget.

Mr. TOBIAS. That is correct, Mr. Chairman, and I think that Mr. Finch's statistics bear that out, and that the Internal Revenue Service feeling it can somehow take care of this is not true.

Chairman PICKLE. Now, Mr. Calkins, you made a very impressive presentation. The Internal Revenue Service tells us that they meet regularly with members of the ABA, and I suppose the CPA organizations, too, in an attempt to try to improve the overall system. Are these meetings productive?

Mr. CALKINS. We believe they are, Mr. Chairman. We hold them usually in the fall, and they help set our agenda of matters that we will work on together.

Chairman PICKLE. You say you believe they are, and yet you listed about five different areas that were horrendous in many respects. Are these problems you have asked IRS to work on and they haven't responded to?

Mr. CALKINS. We consider that is the function of your committee and not of the tax section of the American Bar Association. We don't use these meetings as an occasion to try to demand better performance from the IRS. We don't think that is our function.

Chairman PICKLE. When you meet, you don't discuss the weekend's golf game.

Mr. CALKINS. We do not.

Chairman PICKLE. What issues or problem areas do you discuss specifically that you think could be helpful that you are making some progress on?

Mr. CALKINS. As I recall the agenda of our meeting last fall, it included a particular problem that the Chief Counsel had with a form of tax shelter which he wanted to take substantial action to discourage people from investing in. He wanted to ascertain wheth-

er he would have the support of the tax section in doing so, or whether we would attack his procedures as being not orthodox and perhaps not protective enough of taxpayers.

Chairman PICKLE. How often do your committees meet with the IRS?

Mr. CALKINS. Members of our various committees, of whom we have 25 or 30, are meeting with somebody from IRS every week.

Chairman PICKLE. Do your committees have separate meetings with the Internal Revenue Service? If you have 25 different committees, how many meet with the Internal Revenue Service?

Mr. ELLENTUCK. We have about 25 committees, many of which meet on a continual basis with IRS. Occasionally we join with the bar in our meetings with the IRS. Many times we meet separately. One of our subcommittees is tax forms. They work constantly with the IRS and have been a tremendous help to them. Let me say that we have worked with the IRS on a number of positive suggestions we have made to improve the correspondence backlog and a number of other IRS problems. They are implementing a number of the suggestions, but not enough of them as yet.

Chairman PICKLE. What reaction do you get from IRS on these suggestions you are making? Either one of you.

Mr. CALKINS. Most of the subjects on which we meet with the IRS are questions of legal interpretation of rulings. "How should this portion of the code be interpreted?" We occasionally meet with respect to the administrative problems of the Internal Revenue Service. We asked several people from our administrative practice committee to visit several service centers in the course of the year, where they met with IRS administrators. But that tends to be a minority and a rather small one of the agendas of our meetings with the IRS.

Chairman PICKLE. I take it your primary question, when you meet with the IRS, is one of interpretation of legal rulings and decisions and how your group ought to interpret them.

Mr. CALKINS. That is correct, Mr. Chairman.

Chairman PICKLE. Rather than administration changes.

Mr. CALKINS. Yes.

Chairman PICKLE. Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman. Following up on that topic, I would like to ask both Mr. Calkins and Mr. Ellentuck how you feel the relationship between practitioners and the IRS is. Commissioner Egger and I used to discuss this subject at length, and I feel that the long-range success of the Service will require good relationships with practitioners.

Maybe Mr. Ellentuck first. What do you think the relationship is, and if it needs improvement, how would you improve it?

Mr. ELLENTUCK. I think there are two levels of relationships. One is with the national organization, which is extremely good. The IRS solicits our viewpoints, listens to us, and works with us. I think our relationship has improved considerably. The relationship with the average practitioner is a little more difficult because of the increasing complexity of the tax laws. The practitioner is frustrated. The correspondence backlog has also been a serious frustration for us.

And there is also a trend which I don't believe the IRS is particularly responsible for, and that is the tendency to require more and

more from the C.P.A. in helping enforce the tax laws. While this may appear to be a positive trend, it is costly to the taxpayer and creating serious friction with the practitioner.

Mr. SCHULZE. How would you suggest, or do you have any suggestions on how that relationship could be improved?

Mr. ELLENTUCK. I think that the relationship is getting better. As Mr. Calkins discussed, the problems are not those of quality at the top—we think top management consists of high-quality people—but problems at lower levels of IRS where you have people that are perhaps not all adequately trained. More effort could go into training of the IRS people in recognition of the fact that there are serious problems in training IRS people as the tax laws get more complicated.

Mr. SCHULZE. Better training across the board.

Would you want to respond to that?

Mr. CALKINS. What he said on behalf of the accountants I could say on behalf of the lawyers. I think the situation is similar.

Mr. SCHULZE. I have felt we should have some kind of either hotline or direct method for practitioners to talk to a human being. The Service sort of feels that carves out a special niche for practitioners, and that they should treat all of their clients the same. It seems to me that practitioners handle an awful lot of accounts and individuals each year, and often don't get the problem until it is a problem, until the second or third notice is out and the individual is saying "This is incorrect, and I have been unable to reach anybody." Do you have any thoughts on that?

Mr. CALKINS. I think most practitioners do have a working hotline because they have had enough contact with people within the Internal Revenue Service in the local district director's office or at the region or in the appeals office. They do know people.

Mr. SCHULZE. My local accountants do not have that kind of relationship. That is where I am getting the complaints from.

Mr. CALKINS. I will ask Mr. Ellentuck to respond.

Mr. ELLENTUCK. If I might say, your practitioners, particularly C.P.A.'s in the area of preparation of returns, tax controversies and tax planning are critical to the IRS operation. I think we C.P.A.'s need the IRS to help us function properly, and I think the IRS needs us and needs the attorneys as well. Many practitioners do have hotlines, but many don't, and I would encourage a more formal hotline arrangement. This is particularly important with the erosion of the IRS' ability to respond to inquiries, not only to practitioners, but to taxpayers as well.

Mr. SCHULZE. I think one is being tested in Atlanta or somewhere. Maybe it will turn out to be a great success and we will get that.

Mr. Tobias, out of the 4,700 additional staff you would recommend, how many would be in compliance, and how many in taxpayer service?

Mr. TOBIAS. We are recommending 2,000 additional people in investigation, collection and taxpayer service, 500 people specifically in taxpayer service to answer approximately 5 million more telephone calls.

Mr. SCHULZE. Out of 4,700, you would only have 500 in taxpayer service and the rest would be in compliance?

Mr. TOBIAS. That is correct. Fifteen hundred revenue officers and 500 taxpayer service. That is what we think is doable. That isn't what we need.

Mr. SCHULZE. I want to see the accent on service. I think we get behind in service. Failing to service individuals' accounts is how we get the compliance erosion.

Mr. TOBIAS. That is why we recommend in addition the 2,700 positions in returns processing be restored.

Mr. SCHULZE. You also explained to me how budgetary restraints caused the erasure of the tape and last year's problem. When we talk about last year's problem, we are basically talking about Philadelphia. There were problems in other places, but the Philadelphia problem was the one that got most of the media attention, most of the problems.

In our pretty thorough investigation, I didn't see anywhere that budgetary restraints caused the problem. Now, if you can tell me how, I would be happy to hear it.

Mr. TOBIAS. Originally what happened in Philadelphia is that there was an erasure of a tape, and Philadelphia certainly was the worst, but it wasn't the only place there were problems in the Internal Revenue Service in processing returns last year. There is a lot of evidence that, all of the records the General Accounting Office put out, the charts you saw today in terms of the return rate, the fact there wasn't sufficient training in 1985 to bring people up to speed, all of those are resource problems.

The fact that when things started to break down there wasn't any stretch, I think that one of the GAO reports talked about people working 70 and 80 hours a week over an extended period of time. Those are not efficient people; those are people working tired because of stretched resources, they couldn't bring people in. I think there is evidence in every single GAO report that was put out, and Mr. Finch has put out a whole lot of them since last year at this time, highlight clearly and specifically the impact of inadequate resources on the problems that happened in 1985.

Mr. SCHULZE. Well, I can understand your appeal for more people. I, too, think we need more people, but I think we go a little far when we blame everything last year on that. I think the tape erasure and the mix-up in the duplicate returns and the series of events which caused that huge problem, which was then multiplied many times—

Mr. TOBIAS. There is no question in my mind the service center director bore a great deal of responsibility for what happened in Philadelphia. We have been talking to that service center director for several years about the way that quantity had been emphasized and quality deemphasized, and that management philosophy in that service center contributed much to the problems that occurred in the Philadelphia Service Center.

Mr. SCHULZE. I see my time has expired. I would like to thank the panel.

Thank you, Mr. Chairman.

Mr. DORGAN [presiding]. Thank you, Mr. Schulze.

Mr. Finch, I read your testimony, and was interested in a lot of the information you provided the committee. One of the things that you didn't comment on, and I have not heard anything about

today, is on the management of the Internal Revenue Service itself. I think responding, for example, to the Philadelphia situation, I agree with what Mr. Schulze was saying. There was human error in that situation, and there was also a management information problem in that situation, so there were simply management problems that resulted from mistakes that people made at the Philadelphia center.

But today we have been talking about the larger problem of not being able to do the job that most of us expect to be done with the amount of resources that are currently available, and that results in substantial revenue that is not collected and results in a burgeoning accounts receivable you might not be able to do much about. That is lack of resource problems. But there is another issue that I don't know much about.

Is the Internal Revenue Service well managed from a management systems standpoint? We have nearly 100,000 people here and a management system of some type, and the question that I ask myself sometimes is, have we created a musclebound management system here that acts and behaves and responds as efficiently and effectively as we should expect? Have there been any comprehensive management studies of the Internal Revenue Service management style and effectiveness?

Mr. FINCH. Not in terms of management style and effectiveness that I am particularly aware of, sir, not from a personal standpoint. I have been around government for a while and I have seen a lot of different agencies, and I think the managers at IRS could hold their own with any I have seen. I think there are some pretty good people over there.

I think where some of the problem comes into play is in the management information systems and the information those managers are provided with to do their management chores. One in particular, which ties in with the subject of the hearings today, is the management information system that they use to make resource allocations among the various functions. The system does not produce the data that they need so that they can integrate their decisionmaking across the functions. Basically——

Mr. DORGAN. That is what I am trying to get at. The fact that there are good managers doesn't necessarily mean the place is well managed. General Custer was a good manager, he had some bad information, and things didn't end up very well for him.

The question is, the management information system that we have in the Internal Revenue Service related to the people who are using that to make judgments, is it something we should be proud of and say that is at this point blameless for the things we see in the numbers? Is it simply lack of resources that is the problem? Or should we be looking at some more fundamental issues involving the management of the Internal Revenue Service?

Mr. FINCH. You should be looking at the management information systems, too, sir.

Mr. DORGAN. How should we do that?

Mr. FINCH. We issued a report about 2 years ago, I guess, perhaps 3 years, in which we talked about the resource allocation process and the need for a management information system so that the top service managers could look across all of the activities in

the service and make decisions about perhaps moving or reallocating resources among the functions and how to do that on a correct marginal yield basis to get the biggest bang for the buck.

IRS has done some work in that area. They are beginning now to refine their management information systems within the various functions, which could stand some improvement themselves. They are also trying to bridge that now with a resource allocation model. I have forgotten the acronym for the particular model, perhaps Mr. Persky remembers it, but they hope to have that online sometime this year. I think one thing the subcommittee might wish to do is have IRS provide information on that particular management information system and have some discussion in terms of what it will do and what it won't do.

Mr. DORGAN. That would be useful. Sometimes I wonder if we don't, because of modern computers, require such a disproportionate share of our resources to go into hardware and data gathering that we don't have enough resources at the end to do what we have to do with the information we have. We are loading up now with a staggering amount of information about income streams. In the old days you would get your W-2 forms and not even keypunch those. They would sit in a box, and you would hope taxpayers believed you were keypunching them. These days you get not only that information, but information from different sources, and you just wonder sometimes, from a management standpoint, whether we have enough money left over to do anything other than simply keep score.

But I would like to follow up on that at some point with the GAO and perhaps with the Service in terms of evaluating some management questions and information systems at the IRS.

Mr. PERSKY. I would like to follow up on one thing Congressman Schulze asked about and Mr. Tobias responded to. I would like to get it on the record that whatever happened in the Philadelphia Service Center was just 1 center out of 10. All 10 centers had difficulties last year, difficulties at a level I think we had never experienced before. And I don't think that we can attribute the problems in the Philadelphia Service Center to one individual. We had a breakdown at the Philadelphia Service Center. We are probably somewhat lucky we didn't have a breakdown in other areas.

With respect to management information gathering mechanisms, if you break the Service into three big chunks—and there are lots more—you have Returns Processing, Examination and Collection. What we discovered last year was a problem, and when we asked the questions to solve the problem, we couldn't get answers fast enough. We just couldn't get the information. We have now developed systems to provide the information we need on a timely basis. In examination, we have developed a marginal yield analysis that is providing us that information.

And the third big chunk is in collection. We hope to bring that onstream later on this year. We don't have a perfect system, but we are in the process of developing it. And if you will bear with me one more second, the need for a management information system has not appeared as critical in the past as it is today. One of the things that we have known in the past is if we put another dollar in examination, we would get \$10, \$15 or \$20 in return. If we put

another dollar in collection, we would get \$10, \$15 or \$20 in return. In some respects, we didn't care if we got \$1 or \$15 because we knew the yield was going to be so high, it was going to be well worth the expenditure.

Now, in times of tight resources and the need to improve compliance, we need to substantiate these kinds of things. We are developing systems to provide more accurate projections.

Mr. DORGAN. Let me, before we conclude, ask one final question relating to information from the Service. The \$45 billion in current accounts receivable, I think it is safe to say, represents the largest accounts receivable in America. Don't we all agree with that?

Mr. PERSKY. Other than the U.S. Government, perhaps.

Mr. DORGAN. We have less resources to deal with it than we had to deal with the \$25 billion accounts receivable.

A question for the Acting Commissioner and the folks down at the Service is, what are you going to do at this point? Are you just going to do the best you can with fewer inadequate resources? And, second, are you going to do anything at this point to ask for some additional funds from this administration? If so, how are you going to do that and when?

Mr. PERSKY. Let me take the last part of your question first, and that is we are now reviewing the experience of the 1986 filing season. We put in a lot of new programs, we have done things somewhat differently, we tried to build in quality on the front end, and we think we are going to get savings from those quality initiatives down the road.

When we have finished our analysis of what our experience was with 1986, we are going to have a better sense of 1987, and if in the event we need to amend our budget or go with a supplemental in 1987, that decision will be made down the road.

With respect to the \$45 billion figure for collection, I wish I had a simple answer for you. It is a complicated problem. The first thing that we are trying to do is trying to determine the source of that increase in accounts receivable. I hate to continue to harp on last year's filing season, but it is a combination of that, a problem we had with the FTD, Federal tax deposit system, and a number of other problems. We may have artificially inflated that accounts receivable figure.

In addition, there have been some changes in accounting. I don't want to minimize at any moment the seriousness of that \$45 billion accounts receivable figure—it is large, it is too large—but we need to know why it grew in order to resolve that problem. You are absolutely right when you say we have fewer resources than we had a couple years ago. And one of the reasons for that is the bringing on-stream of the automated collection system. The ACS system, as we call it, is doing remarkable things for the collection function.

But we don't know the source of this recent balloon or rise in the accounts receivable area.

Mr. DORGAN. It sounds like a supply-side approach, where if you reduce the money for enforcement you will be expected to reduce the accounts receivable.

Mr. PERSKY. I don't think it is going to quite work out that way. I think we have demonstrated in the ACS area—this is not the only

area the Service has done this—an ability to use computer resources to solve problems that were labor intensive before.

Mr. DORGAN. Could I ask for one final piece of information from the IRS. Would you send to the subcommittee your evaluation of what we should do in terms of the commitment of resources for this accounts receivable problem? Looking at it as tax administrators, not as folks who are concerned about the OMB or concerned about others who think all public employees are slothful, indolent folks and all government bad, but, rather, looking at it from the standpoint of a tax administrator and what reasonably should you do to respond to a problem of the magnitude we now have in accounts receivable, and give us your best estimate of the resources necessary to manage that problem. Could we expect that?

Mr. PERSKY. We will do that.

[The information follows:]

ACCOUNTS RECEIVABLE INVENTORY

In order to deal with the current accounts receivable problem, Collection could hire, train and effectively deploy 2,000 additional staff years in accounts receivable. This staffing would be used to work taxpayer responses to balance due notices and active field taxpayer delinquent accounts in order to speed up revenue collections and reduce the accounts receivable inventory.

Mr. DORGAN. I want to thank all the members of the panel for some excellent information. That concludes the hearing. Thank you very much.

[Whereupon, at 12:50 p.m., the hearing was adjourned.]

APPENDIX

BACKGROUND MATERIAL COMPILED FOR SUBCOMMITTEE MEMBERS

- A. Staff Budget Analysis
- B. Budget Request Comparisons:
Columns:
 - (1) IRS submission to Treasury
 - (2) Treasury submission to OMB
 - (3) OMB approved submission to Congress
- C. Examination Coverage FY 1980-87 (Projected vs. Actual)
- D. Staff Positions FY 1975 to FY 1985 (By Program)
- E. Current Inventory Data -- Correspondence and Adjustment, Unpostables, and Accounts Receivable (Uncollected Taxes Due)
- F. Letter from Secretary Baker Concerning 1986 Emergency Supplemental Request
- G. Letter from Former IRS Commissioner
- H. Letter from American Bar Association

STAFF BUDGET ANALYSIS

ATTACHMENT A

IRS BUDGET REQUEST FOR FY 1987

SUMMARY: STAFF POSITIONS (BY ACCOUNT)*	ACTUAL 1985	AUTHORIZED 1986**	ESTIMATED 1987
1. Salaries and Expenses	2,271	2,071	2,044
	-200 -27 -227		
2. Processing Tax Returns	26,075	28,944	27,327
	+2,869 -1,617 +1,252		
3. Examination & Appeals	35,089	35,923	38,974
	+834 +3,051 +3,885		
4. Investigation, Collection, & Taxpayer Service	28,824	26,786	26,739
	-2,038 -47 -2,085		

* IRS appropriations are broken down into four separate accounts.

** Includes FY 1986 Supplemental Request.

ACCOUNTS* BREAKDOWN - IRS BUDGET SUBMISSION

(*IRS's Appropriation is broken down into four separate accounts)

I. Salaries and Expenses

The Salaries and Expenses Appropriation provides funding for policy formulation and executive direction of the Internal Revenue Service, for management services, and for the centralized direction of activities which perform independent review of operations and protect the integrity of the Service. The appropriation consists of two activities: Executive Direction and Management Services.

The Executive Direction activity is composed of the Commissioner, the Deputy Commissioner, and their immediate offices, including Public Affairs, the Equal Employment Opportunity Program, the Taxpayer Ombudsman and the staff of the Assistant to the Commissioner (Legislative Liaison); the three Associate Commissioners for Operations, Policy and Management, and Data Processing and their immediate offices; the Chief Counsel and immediate staff; and the immediate office of the Assistant Commissioner (Inspection).

The Management Services activity is divided into 3 areas, each responsible for specialized support programs: The Human Resources area, the Planning, Finance and Research area, and the Support and Services area.

Requested resources for the Salaries and Expenses Appropriation total 2,044 average positions and \$95.1 million, a decrease of 27 average positions (a decrease of 227 positions from actual 1985 level) and an increase of \$5.2 million from the revised FY 1986 level.

	ACTUAL 1985	AUTHORIZED 1986	ESTIMATED 1987
Staffing (Total)	2,271	2,071	2,044
1. Executive Direction	126	127	122
	+1		-5
	-4		
2. Management Services	2,145	1,944	1,922
	-201		-22
	-223		

II. Processing Tax Returns

The Processing Tax Returns Appropriation provides funding for two activities: Returns Processing and Revenue Accounting, and Computer Services.

The Returns Processing and Revenue Accounting activity provides resources to process tax returns, account for tax revenues, issue refunds and notices, and process information returns for the document matching program. Processing performed by this activity is basic for tax administration and provides necessary input to almost all other IRS programs. Funding is contained in this activity for the National Computer Center; the ten IRS Service Centers; and for preparation of required statistical information on income and other aspects of the tax system. This activity includes the Office of the Assistant Commissioner (Returns and Information Processing), the Returns Processing and Accounting Division in the National Office and the counterpart Assistant Regional Commissioners in the seven regional offices.

The Computer Services activity, located in the National Office, includes the Office of the Assistant Commissioner (Computer Services), and the newly established Office of the Assistant Commissioner (Tax Systems Redesign), which is responsible for the procurement and implementation of a modernized, cost-efficient tax system, featuring up-to-date ADP hardware, software, file structure, data communications, and security. Support provided by this activity includes comprehensive developmental data processing support for most Service programs, including the evaluation, development, and implementation of computer systems, software and hardware requirements. The Computer Services activity also is responsible for the modernization of the Service's mainline computer systems. Almost three quarters of the resources devoted to ADP and information technology are included in this appropriation, with the balance allocated to the other three operating accounts.

The budget proposed for the two activities financed under the Processing Tax Returns Appropriation totals 27,327 positions and \$1,262.9 million, a net decrease of 1,617 positions and an increase of \$49.1 million over FY 1986.

	ACTUAL 1985	AUTHORIZED 1986	ESTIMATED 1987
Staffing (Total)	26,075	28,944	27,327
1. Returns Processing & Revenue Accounting	24,449	27,434	25,844
	+2,985		-1,590
	+1,395		

2. Computer Services	1,626	1,510	1,483
	-116		-27
	-143		

The resources requested for Returns Processing and Revenue Accounting total 5,844 positions and \$956.7 million, a decrease of 1,590 positions and an increase of \$9.4 million from the 1986 level. IRS estimates that almost 180 million tax returns and 10 million supplemental documents will be received and processed in FY 1987--3.5 million more returns and supplemental documents than currently projected for FY 1986.

STAFF NOTE: Serious questions arise regarding the wisdom of cutting Returns Processing given these facts:

- (a) the IRS has yet to fully recover from the abysmal filing season of 1985;
- (b) resource demands have been higher in the Service Centers this filing season than that even projected under the FY 1986 urgent supplemental request;
- (c) current Service Center inventories remain unacceptably high (see attachment); and
- (d) the sheer number of returns filed in 1987 is expected to increase by 3.5 million.

The resources requested for Computer Services will be primarily devoted to maintaining existing ADP systems and continuing projects initiated in prior years, such as IDRS (Integrated Data Retrieval System), Tax System Redesign, Automated Examination System and Information returns Program enhancements. The request totals 1,483 positions and \$306.2 million, a decrease of 27 positions and an increase of \$39.7 million.

STAFF NOTE: It is unclear whether this budget has accounted for the continuing costs of the earlier computer conversion problems or for the need to increase computer capacity, efficiency and reliability. The current state of IRS computers and its computer modernization plans should be examined during the hearing: Is there a cohesive plan to bring a state-of-the-art computer system to IRS, and if so, when? Where is the money going?

III. Examination and Appeals

The Examination and Appeals Appropriation provides funding for three activities: Examination, Appeals and Tax Litigation, and Employee Plans and Exempt Organizations.

The Examination activity is the Service's primary program for determining taxpayers' correct income tax liability. To do this, the Service examines taxpayers' books and records to verify reported income and deductions, uncover unreported income, and validate exemptions and credits. This activity includes: the Office of the Assistant Commissioner (Examination) at the National Office, the offices of the Assistant Regional Commissioners (Examination), and Examination personnel in district offices and service centers.

The Appeals and Tax Litigation activity is primarily involved with those cases in which taxpayers disagree with examination results. The Appeals function provides an independent administrative review with the objective of reaching impartial settlement. For those cases that cannot be resolved through the Appeals process, Tax Litigation, which is part of Chief Counsel, represents the Service. The National Office and field components of both functions are funded in this activity.

The Employee Plans and Exempt Organizations activity is responsible for maintaining compliance with certain tax laws by monitoring employee pension plans, by determining the qualifications of organizations seeking tax-exempt status, and by examining the returns of exempt organizations. The Employee Plans function is mainly staffed at ten key districts and several associate districts with managerial and program development staff in regional offices and at the National Office. The Exempt Organizations function, which monitors organizations exempt from federal income tax, funds auditors in district offices along with managerial and program development staff in regional offices and at the National Office. Functional Supervision for both programs is provided by the Assistant Regional Commissioner (Examination) in each region and by the Assistant Commissioner (EP/EO) in the National Office.

over the next 3 years and \$10.3 billion between FY 1987-1991, by adding 2,500 positions each year for 3 years to the examination of tax returns. The Service will begin advance hiring late in FY 1986 to ensure full revenue potential in FY 1987.

In FY 1987, under this initiative, the Service will examine 120,000 additional returns. Additional tax, penalties and interest, ultimately assessed from these examinations is estimated to be \$829 million.

STAFF NOTE: These figures give way to these important issues which should be addressed at the hearing:

- (1) Why are 2,500 positions only resulting in 120,000 additional returns examined (that's 48 returns per position)?
- (2) If 120,000 returns are resulting in only \$829 million in additional tax, penalties and interest ultimately assessed, is this (about \$7,000 per return) initiative targeting the most productive returns? How much of this assessment will actually be collected and when and by whom? (Collection staffing is cut below 1985 levels.)
- (3) Why is the examination coverage or audit rate still so low?

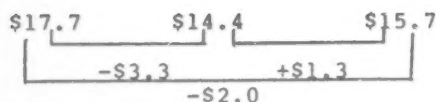
Furthermore, while this initiative will increase additional tax recommended and ultimately assessed over FY 1986, total additional tax assessed in FY 1987 is still \$20 billion below the actual 1985 level.

SELECTED WORKLOAD DATA	ACTUAL 1985	ESTIMATED 1986	ESTIMATED 1987
Examination Rate (%)	1.34	1.14	1.42
(1982 = 1.63%)		-0.20	+0.28
			+0.08

Selected Revenue Data
(billions of dollars)

Total Additional Tax Recommended	\$17.7	\$14.7	\$16.2
		-\$3.0	+\$1.5
			-\$1.5

Additional Tax Assessed



2. Appeals and Tax Litigation

Resources of 4,907 positions and \$188.8 million are requested in FY 1987, an increase of 497 positions and \$28.8 million above the FY 1986 level.

A Tax Shelter Initiative is proposed, in this request, to reduce the number of tax shelter cases (representing some 372,000 returns) now in inventory. With the additional staffing requested, IRS will be able to close almost 15,000 additional appeals and resolve over 11,000 additional cases in tax litigation. The tax shelter initiative will accelerate the collection of tax revenues by some \$600 million in FY 1987.

STAFF NOTE: It must be noted, however, that ending inventories in both Appeals and Tax Litigation will continue to climb under this budget request.

SELECTED WORKLOAD DATA (in thousands)	ACTUAL 1985	ESTIMATED 1986	ESTIMATED 1987
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Appeals

Disposals	63.9	63.6	74.1
Penalty Appeal Disposals and EP/EO Determinations	4.0	4.0	4.0
Case Inventory Per Appeals Officer	63.3	101.1	98.5
Ending Inventory	66.5	109.6	120.2

Tax Litigation

Tax Court and Refund Case Receipts	50.8	68.0	71.6
Closures	36.1	43.5	50.1
Ending Inventory	82.2	106.7	125.9

3. Employee Plans and Exempt Organizations

A total of 2,393 positions and \$99.2 million is requested in FY 1987 for Employee Plans and Exempt Organizations, a decrease of 8 positions and an increase of \$4.1 million over FY 1986.

STAFF NOTE: It should be mentioned that while staffing decreases slightly, workload, on the other hand, for Employees Plans in particular, has dramatically increased with the passage of the Tax Equity and Fiscal Responsibility Act of 1982, the Retirement Equity Act of 1984 and the Deficit Reduction Act of 1984. These Acts will require the amendment of virtually every qualified retirement plan during the next few years in order for these plans to retain their qualified status under the Internal Revenue Code.

The examination rate for Employee Plans remains lower than that of FY 1985. The Exempt Organizations examination coverage rate will drop to a new low.

SELECTED WORKLOAD	ACTUAL 1985	ESTIMATED 1986	ESTIMATED 1987
<u>Examination Coverage Rate</u>			
Employee Plans	1.60%	0.69%	0.80%
Exempt Organizations	1.95%	1.55%	1.40%

IV. Investigation, Collection and Taxpayer Services

The Investigation, Collection, and Taxpayer Service Appropriation provides funding for four activities: Tax Fraud Investigations, Collection, Taxpayer Service, and Enforcement Litigation and Rulings.

The Tax Fraud Investigations activity is responsible for investigating criminal violations of the Internal Revenue laws. This activity includes: the Office of the Assistant Commissioner (Criminal Investigation) at the National Office, the Office of the Assistant Regional Commissioners (Criminal Investigation), and enforcement personnel in district offices and service centers.

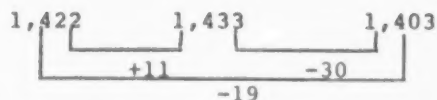
The Collection activity provides for collecting unpaid accounts, as well as securing unfiled tax returns and payments. Collection personnel in district offices and service centers are funded under this activity, as are managerial and program formulation personnel in the National Office and in regional offices.

The Taxpayer Service activity provides information and assistance to taxpayers to help them comply with the tax laws. Funded are personnel in the district offices who have direct contact with taxpayers, along with managerial and program development staff in the National office and in regional offices.

The Enforcement Litigation and Rulings activity provides legal support for the Tax Fraud and Collection functions, prepares and reviews proposed legislation and regulations, interprets tax statutes, and provides general legal advice within the Service. Legal and support staff in this activity are in district and regional offices and in the National Office.

The budget proposed for the four activities financed in the Investigation, Collection, and Taxpayer Service Appropriation totals 26,739 positions and \$1,136.6 million, a decrease of 47 positions and an increase of \$41.3 million over the FY 1986 level.

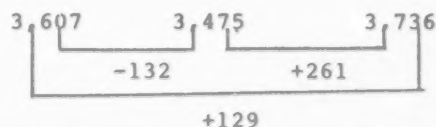
	ACTUAL 1985	ESTIMATED 1986	ESTIMATED 1987
<u>Staffing (Total)</u>	28,824	26,786	26,739
1. Tax Fraud Investigations	4,686	4,413	4,408
		-273	-5
		-278	
2. Collection	18,132	16,056	16,068
		-2,076	+12
		-2,064	
3. Taxpayer Service	4,584	4,884	4,860
		+300	-24
		+276	

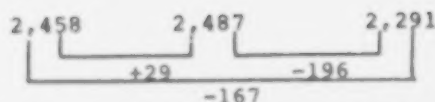
4. Enforcement Litigation
and RulingsFY 1987 Program Breakdown1. Tax Fraud Investigations

The resources for this activity in FY 1987 total 4,408 positions and \$223.8 million, a decrease of 5 positions and an increase of \$13 million over the FY 1986 level. A greater emphasis is being placed on the General Enforcement Program (GEP) due to the growing amount of activity involving fraudulent tax shelters, questionable refund schemes, offshore banking, tax havens and the need to maintain a strong presence in the illegal tax protester area. IRS will continue to commit a substantial level of resources to the Special Enforcement (SEP) emphasis areas of organized crime and narcotics trafficking. In addition, the Service will maintain its commitment of resources to the President's task forces on organized crime and drug enforcement.

STAFF NOTE: It should be noted that even though GEP tax fraud investigations initiated will increase in FY 1987, SEP investigations will decrease. In addition, even though the FY 1987 staffing level is only 5 positions below the FY 1986 level, it is 278 positions below the actual FY 1985 level. The obvious question is one of adequacy of resources, given the Service's own recognition of the growing amount of activity involving tax shelters, etc.

SELECTED WORKLOAD DATA	ACTUAL 1985	ESTIMATED 1986	ESTIMATED 1987
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Tax Fraud Investigations
InitiatedGeneral Enforcement
Program

Special Enforcement
Program

Total

6,065

5,962

6,027

2. Collection

The proposed budget for Collection totals 16,068 positions and \$635.5 million in FY 1987, an increase of 12 average positions and \$28.3 million above the FY 1986 level.

In the Accounts Receivable Program, the Service will complete action on some 2.6 million unpaid accounts and collect \$8.9 billion in delinquent tax revenues, an increase of \$205 million over FY 1986. In addition, the Service will collect revenues of \$8.6 billion from initial billings on unpaid accounts, an increase of \$233 million over FY 1986.

The Delinquent Returns Investigations Program identifies taxpayers who have not complied with their filing requirements. In FY 1987, the requested resources will enable the Service to secure 3.4 million delinquent returns and assess \$5.3 billion in unreported taxes, an increase of \$123 million over FY 1986.

The Returns Compliance Program (RCP) identifies taxpayers who have never filed tax returns. Plans call for continued efforts to identify nonfilers in FY 1987 with assessments from the program estimated at \$15 million, based on securing 9,900 returns.

In addition to assessments relating to the Delinquent Returns Investigations and Returns Compliance programs, some \$822 million will be assessed as a result of delinquent returns secured from delinquent accounts and such miscellaneous sources as notice and walk-in contacts.

According to IRS budget documents, "FY 1985 was the first full year of operation for the Automated Collection System (ACS) which utilizes modern computer and telephone technology to improve office operations and to accelerate the collection of unpaid taxes. The ACS has produced staff savings of over 1,700 average positions during Fiscal Years 1984 and 1985. It is the initial step in a series of efforts to control increasing workload through improved productivity. During FY 1985, the Service began development of an integrated system that will automate the remaining collection

activities--the Collection field and special procedures functions and Collection service center operations. This integrated system will provide Collection employees with direct access to a taxpayer's account and will result in improved case processing and taxpayer relations. Development of this system will continue through FY 1986 with nationwide implementation scheduled during FY 1987 and 1988."

"We have expanded our efforts to deal with taxpayers that do not voluntarily file their tax returns by using automated programs that allow us to complete returns for nonresponsive taxpayers based on available information documents. Collection is also testing the use of revenue officers to investigate possible underreporting of employment tax liabilities by businesses."

"These improvements, along with the revenue initiative that was authorized by Congress in FY 1983, have helped the Collection activity to increase revenue collections by 11% to \$18.2 billion in FY 1985 and to make the first significant reductions in delinquent account inventories, 13%, since the mid-seventies."

POSITIONS	ACTUAL 1985	ESTIMATED 1986	ESTIMATED 1987
Accounts Receivable	14,042	12,452	12,464
		-1,590	+12
		-1,578	
Delinquent Returns Investigations	3,898	3,499	3,499
		-399	
		-399	
Returns Compliance Program	192	105	105
		-87	
		-87	
Total (1984=19,194)	18,132	16,056	16,068
		-2,076	+12
		-2,064	

STAFF NOTE: As is shown above, Collection positions are actually reduced by 2,064 from the actual FY 1985 level, and by 3,126 from FY 1984. Meanwhile, workload data set forth below indicates fewer dollars will be collected in Accounts Receivable than in FY 1985; fewer dollars assessed in Delinquent Returns Investigations; and higher inventories (this is uncollected, but owed, tax revenues) in all programs.

It is important to note that latest information from IRS (see attachment) and GAO show that the Accounts Receivable Inventory is, in fact, at an all time high, in direct contradiction to the Budget Submission statements. New facts, such as these, call into question the entire Collection budget. Also note that the Accounts Receivable positions have been reduced by 1,578 positions from the FY 1985 level.

SELECTED WORKLOAD DATA	ACTUAL 1985	ESTIMATED 1986	ESTIMATED 1987
<u>Accounts Receivable</u> (B=Billions, M=Millions)			
Total Dollars Collected	\$18.26 B	\$17.05 B	\$17.49 B
Taxpayer Delinquent Account (TDAs) Dispositions	2.7 M	2.57 M	2.62 M
TDA's Closing Active Inventory	1.69 M	1.21 M	0.891 M
Revenue in TDA's Active Inventory	\$9.14 B	\$6.57 B	4.61 B
<u>Delinquent Returns Investigations</u>			
Additional Dollars Assessed	\$5.7 B	\$5.2 B	\$5.3 B
Delinquent Returns Secured	3.42 M	3.40 M	3.44 M
Taxpayer Delinquent Investi- gations Disposed (TDI's)	1.48 M	1.55 M	1.57 M
Closing TDI's Active Inventory	1.04 M	1.10 M	1.06 M

Returns Compliance Program

Additional Dollars Assessed	\$10 M	\$12 M	\$15 M
Delinquent Returns Secured	7,000	8,000	10,000
Leads Disposed	51,000	28,000	28,000

Other Delinquent Returns Yield

Dollars Assessed	\$637 M	\$800 M	\$822 M
Delinquent Returns Secured	341,000	372,000	372,000

3. Taxpayer Service

Resources requested for FY 1987 total 4,860 positions and \$210.1 million--"the same basic level budgeted in FY 1986 after adjusting for realignment of administrative services". Over 45 million taxpayers will be served through direct assistance. Taxpayer education programs and automated responses will provide information to another 19 million taxpayers.

Timely tax law and account assistance through the toll-free telephone program, walk-ins and correspondence will continue to be provided in FY 1987. Also, the Outreach program will provide tax law information and group tax return preparation assistance at community and business locations. The Tax Counseling for the Elderly program will be funded at the FY 1986 level. Quality assistance will be assured with new emphasis in training and managerial review of employee performance. Increased emphasis will be placed on assisting taxpayers in the post-filing period (May through September) to provide better assistance to taxpayers who receive notices from the Service or who have account related problems.

The use of computer controlled multifunctional equipment providing both tax law information and refund information will also be continued and will be accessible to taxpayers nationwide.

POSITIONS	ACTUAL 1985	ESTIMATED 1986	ESTIMATED 1987
Full-Time Permanent Taxpayer Service Specialists	557	733	683
	+176		-50
	+126		
Taxpayer Service Representatives	1,121	1,665	1,715
	+544		+50
	+594		
Other Permanent	1,189	1,200	1,182
	+11		-18
	-7		
All Other WAE/Part-time/ Temporary	1,640	1,190	1,184
	-450		-6
	-456		
Details	77	96	96
	+19		
	+19		
Total	4,584	4,884	4,860
	+300		-24
	+276		

STAFF NOTE: While staffing increases slightly, the selected workload data shows that fewer taxpayers--over 4 million--will receive direct assistance in FY 1987 than in 1985. Note that fewer taxpayers (even when considering Tele-Tax contacts) will be assisted even when the IRS estimates that an additional 3.5 million returns will be filed in FY 1987.

SELECTED WORKLOAD DATA	ACTUAL 1985	ESTIMATED 1986	ESTIMATED 1987
	(in Millions)		
Taxpayers Assisted	50.2	45.657	45.657
		-4.54	
Tele-Tax Contacts	8.3	10.0	12.0
		+3.7	
Total Contacts	58.51	55.657	55.657
		-2.85	
Total Taxpayer Education Participants	6.01	6.48	6.98
		+0.97	

4. Enforcement Litigation and Rulings

The requested resources of 1,403 positions and \$67.2 million in FY 1987 represent a decrease of 30 positions due to reorganization.

STAFF NOTE: The workload data indicates that while total staffing is being decreased, and even though four more attorney positions are added, workloads and inventories are increasing, and case closings and rulings are holding steady or decreasing.

	ACTUAL 1985	ESTIMATED 1986	ESTIMATED 1987
<u>Positions</u>			
Attorneys	454	476	480
	+22 +4 +26		
Other	968	957	923
Total	1,422	1,433	1,403
	+11 -30 -19		

<u>Selected Workload Data</u>			
Enforcement and Litigation Case Receipts	42,800	45,500	48,500
	+2,700 +3,000 +5,700		
Enforcement Litigation Case Closings	40,000	38,500	38,800
	-1,200		
Enforcement Litigation Ending Inventory	32,100	39,100	48,900
	+16,800		
Rulings Issued and Other Tech- nical Projects Completed	40,500	39,700	36,000
	-4,500		

FY 1986 Supplemental Request and Reduction Under
Gramm-Rudman-Hollings

The IRS FY 1986 appropriation, as approved by the Congress in the Continuing Resolution (P.L. 99-190), totals 86,774 positions and \$3,642.8 million. Adjustments are proposed through a program supplemental and a reduction (sequestering of funds) as follows:

(1) Program Supplemental: 6,950 positions and \$340 million:

- restore the effectiveness of tax processing (to process tax returns accurately, issue refunds timely, maintain tax accounts through improved taxpayer correspondence and adjustment capability) 5,558 positions and \$140.2 million;
- improve responsiveness to the public (expand taxpayer service) 670 positions and \$40.8 million;
- strengthen tax enforcement (examine tax returns, collect unpaid taxes, secure delinquent returns, match information documents, process currency and cash transaction reports, settle administrative appeals, litigate tax cases) 722 positions and \$116.8 million;
- meet costs to stay in business (space, rental, employee relocation expenses, toll-free telephone circuitry) \$42.2 million.

(2) Reduction under Gramm-Rudman-Hollings: \$156.6 million:

The Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings), P.L. 99-177, requires reductions, through sequestering of funds already approved, of \$11.7 billion governmentwide--with reductions of 4.9% to defense and 4.3% to domestic spending. Under this Act, the IRS operating budget is being cut by \$156.6 million (4.3%). IRS expects that the reduction can be achieved by cutting administrative and support costs (supplies, office equipment, contracts, etc.), and selected ADP and systems modernization expenditures. It is expected that direct tax filing operations (tax return processing, taxpayer service) and direct revenue-producing programs will not be curtailed.

The revised level for FY 1986, with the above adjustments, is 93,724 positions and \$3,826.2 million for the four operating appropriations.

STAFF NOTE: It is questionable whether the Gramm-Rudman-Hollings reduction can be achieved without affecting programs or staffing levels.

In addition, a recent letter from Treasury Secretary Baker (see attachment) indicates that the delay in passage of the supplemental may well be adversely affecting fundamental Service operations now or in the very near future.

Attachment # B

INTERNAL REVENUE SERVICE
FY 1987 FTE/DOLLARS

Account	(1) Treasury		(2) OMB		(3) Congressional	
	FTE	Act	FTE	Act	FTE	Act
Salaries and Expenses	2,098	144,304	2,086	129,220	2,044	95,147
Processing Tax Returns	28,366	1,298,336	27,315	1,242,632	27,327	1,262,402
Examination and Appeals	39,252	1,617,512	39,195	1,608,182	38,976	1,603,162
Investigation, Collection and Taxpayer Service	28,356	1,211,889	26,773	1,140,158	26,739	1,136,581
TOTAL	98,092	4,272,261	95,369	4,120,192	95,086	4,097,792

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05-07-86

SOURCE: Internal Revenue Service

COMPARISON OF REVENUES

	FY 1960	FY 1961	FY 1962	FY 1963	FY 1964	FY 1965	FY 1966	FY 1967
REVENUE ACTUAL	2,11	2,49	2,09	1,83	1,63	1,47	1,59	1,54
REVENUE BUDGET	2,11	2,49	2,09	1,83	1,63	1,47	1,59	1,54
PERCENTAGE	100	118	104	100	103	102	100	100
REVENUE ACTUAL	2,11	2,49	2,09	1,83	1,63	1,47	1,59	1,54
REVENUE BUDGET	2,11	2,49	2,09	1,83	1,63	1,47	1,59	1,54
PERCENTAGE	100	118	104	100	103	102	100	100
REVENUE ACTUAL	2,11	2,49	2,09	1,83	1,63	1,47	1,59	1,54
REVENUE BUDGET	2,11	2,49	2,09	1,83	1,63	1,47	1,59	1,54
PERCENTAGE	100	118	104	100	103	102	100	100

NOTE: REVENUE ACTUAL REVENUES COMMISSION, BUDGET COMMISSION.

1/ Constitutes only income, estate, gift, and partnerships.
Does not include federal and employment taxes.

FACTORS IMPACTING PERFORMANCE DURING THIS PERIOD

- o Increase in returns filed, from \$4.7 billion in FY 1960 to \$12.8 billion estimated in FY 1967
- o Absorption of new legislation, (e.g., Credit Rollover Profitability Act of 1960, Economic Recovery Tax Act of 1961, Tax Equity and Fiscal Responsibility Act of 1962, Interest and Dividend Tax Compliance Act of 1963, and Deficit Reduction Act of 1966)
- o Shift from directed Gross Income (GI) to Total Positive Income (TPI) as a basis of assessing individual returns
- o Greater emphasis placed on more complex individual (Schedule C), corporate (S-100) and tax shelter returns requiring more in-depth examination time and producing higher yield

SOURCE: Internal Revenue Service

Attachment # D

Internal Revenue Service
Average Positions - FY 1976 to FY 1987

Program	FY 1976	FY 1977	FY 1978	FY 1979	FY 1980	FY 1981	FY 1982	FY 1983	FY 1984	FY 1985	FY 1986	FY 1987	Change FY87-FY76	% Change FY87-FY76
Examination	27,977	27,420	26,393	27,173	28,226	26,913	26,714	26,737	27,273	28,353	28,729	31,156	3,179	11.543
Appeals	1,814	1,481	2,259	2,116	1,973	1,894	1,925	2,125	2,512	2,500	2,580	2,844	1,030	56.803
Comptrol	1,546	1,252	1,449	1,717	1,672	1,713	1,820	1,875	1,942	1,969	1,972	2,158	592	37.882
Tax Fraud	4,182	3,387	4,144	4,395	4,447	4,347	4,264	4,074	4,474	4,466	4,413	4,688	506	12.076
Collection	12,195	11,259	10,966	11,118	11,286	12,075	14,416	17,272	18,183	17,248	15,148	15,132	2,937	24.253
Info. Rtrns. Prog.	1,621	2,220	2,748	2,893	2,963	3,367	3,553	3,419	3,451	4,467	4,962	5,767	4,146	255.773
EP/EO	2,272	2,383	2,654	2,337	2,286	2,142	2,017	2,115	2,432	2,418	2,401	2,393	121	5.333
Total Enforcement	51,447	50,222	51,413	51,648	52,823	53,451	56,747	57,566	60,467	61,721	60,143	63,886	12,439	23.695
Tax Processing	24,780	25,425	25,214	25,461	25,465	23,884	19,723	17,915	16,546	15,465	22,466	28,153	14,273	-18.672
Systems Modernization	---	---	---	---	---	---	---	---	---	---	---	---	---	---
Taxpayer Service	4,449	4,476	5,014	5,263	5,337	5,225	4,865	4,274	4,364	4,434	4,714	4,710	362	8.101
Others	3,228	3,120	3,148	3,133	3,493	3,586	3,922	3,117	3,483	3,225	2,999	2,959	731	22.493
Total Service	84,244	81,743	85,329	86,148	87,444	86,156	82,457	83,483	87,435	92,759	93,724	95,864	10,820	12.843

NOTES:

a Includes Executive Direction, Management Services, Technical Mailings, Statistical Reporting, and the Data Center.

1) The Actual column of the FY 1976-1987 Congressional Submissions were used.

FY 1986 and FY 1987 were derived from the FY 1987 Congressional Submission.

2) Adjustments were made to the budget structures in an attempt to maintain a consistent classification of the program throughout the year.

3) Resources for the 189 projects were extracted from Examination, Collection, Refunds Processing, Computer Services, and Taxpayer Service. Prior to FY 1982, the 189 resources represent the best available estimates rather than actual data.

4) Adjustments to FY were made to the FY 1983 - FY 1986 column to bring the actuals into agreement with 1138 report totals.

5) Systems Modernization includes staff devoted to design and implementation of ACP and systems modernization (SIS, AFS, etc.). Computer operations at IRS service centers are, however, included under Tax Processing.

PC/176/13
Mar. 7, 1986

SOURCE: Internal Revenue Service

CURRENT INVENTORY LEVELSI. Correspondence and Adjustments Inventory:National Total --

<u>April 30, 1984</u>	<u>April 30, 1985</u>	<u>April 18, 1986</u>
564,007	820,575	1,128,883
<u>Percentage of Cases Over 45 Days Old --</u>		
14%	56%	50.4%

II. Unpostable Inventory:

<u>April 30, 1984</u>	<u>April 26, 1985</u>	<u>April 25, 1986</u>
987,140	2,452,010	1,668,923

III. Accounts Receivable Inventory:

<u>Oct. 1, 1984</u>	<u>Oct. 1, 1985</u>	<u>March 31, 1986</u>
\$30.1 Billion	\$43.5 Billion	\$45.3 Billion

Currently Not Collectible--

no data	\$7.6 Billion	\$8 Billion
---------	---------------	-------------

SOURCE: Internal Revenue Service



THE SECRETARY OF THE TREASURY
WASHINGTON

Attachment # F

April 30, 1986

RECEIVED

APR 30 1986

Ways and Means
Subcommittee on Oversight

Dear Jake:

Timely approval of the Fiscal Year 1986 IRS supplemental is essential to maintain current revenue production and the long-term integrity of the tax administration system.

The Administration strongly opposes H.R. 4515 in its present form because of unnecessary add-ons and certain language provisions. I hope that appropriate action will be taken to address the Administration's concerns about H.R. 4515, so that urgently needed funding, such as for the IRS, may be signed by the President in the near future.

If Congress does not approve the President's request for the IRS supplemental funding, or includes it in an unacceptable vehicle such as H.R. 4515 in its present form, the IRS will experience a funding crisis. Because IRS took dramatic management measures early in the filing season to ensure smooth processing, IRS may have to take drastic actions such as those outlined in the attachment, including severe staff impacts.

The IRS has not violated its appropriations. Instead, when the IRS funding situation became critical, the IRS had no choice but to request a deficiency apportionment, which OMB approved. Hiring for frontline activities has already been frozen and low priority expenditures sharply reduced. Little flexibility remains. Additional reductions must come out of revenue-sensitive operations. Total revenue loss from these actions over Fiscal Years 1986 and 1987 is estimated to be in excess of \$3.5 billion.

I strongly urge your support for timely passage of the IRS supplemental request.

Sincerely,

James A. Baker III

The Honorable J. J. Pickle
Chairman
Subcommittee on Oversight
Committee on Ways and Means
House of Representatives
Washington, D.C. 20515

Attachment

POSSIBLE IRS ACTIONS

The following are measures the IRS may have to take if supplemental appropriations are delayed or not approved. The total revenue loss from these measures over fiscal years 1986 and 1987 is estimated to be in excess of \$3.5 billion. In addition, cancellation of ADP acquisitions will severely hamper IRS modernization initiatives, and massive furloughs will have a harmful effect on both IRS morale and its ability to perform its critical mission.

May 1, 1986:

- o Eliminate all but returns processing overtime;
- o Defer acquisition of office equipment, supplies, and services;
- o Freeze hiring in direct revenue-producing programs (examination and collection) and in taxpayer service;
- o Reduce ADP acquisitions;
- o Reduce travel and training by 50 percent; and
- o Release 6,000 temporary employees in examination, collection, and taxpayer service.

July 1, 1986:

- o Freeze permanent hiring, stop all overtime, and release 12,000 employees in service centers;
- o Cancel all remaining ADP acquisitions; and
- o Cancel all remaining travel and training.

September, 1986:

- o Furlough 77,000 permanent IRS employees in service centers, collection, examination, appeals and litigation, and executive direction.

RECEIVED

JAN 17 1986

Ways and Means
Subcommittee on Oversight

January 17, 1986

JAN 23 1986

The Honorable James A. Baker, III
Secretary of the Treasury
Department of the Treasury
Room 3330 Main Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

The Honorable James C. Miller
Director
Office of Management and Budget
Room 252 Old Executive Office Building
17th Street & Pennsylvania Avenue, N.W.
Washington, D.C. 20503

Dear Secretary Baker and Director Miller:

We are all the persons privileged to have served as Commissioner of Internal Revenue between 1961 and 1980. Three of us served primarily in Republican Administrations (Presidents Nixon and Ford) and three in Democratic Administrations (Presidents Kennedy, Johnson and Carter). We are deeply concerned over the health of our economic system and particularly the health of our tax system. The efforts of the Administration and Congress to reduce the budget deficit are to be applauded, although each of us may have different views on how to accomplish this reduction.

This letter is to express our profound concern about the adverse effects which the Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman) may have on our revenue system.

Our tax system has been a source of pride and strength to our country. It depends on the voluntary filing of complete returns by individuals and businesses and the proper reporting of income and deductions. Taxpayers' willingness to cooperate depends significantly on their confidence in the fairness of the system and their perception that it is vigorously enforced against those who do not comply.

We strongly believe that the resources available to the IRS for its job of administering the tax law are inadequate. Essential to the maintenance of our voluntary compliance system is an effective IRS to process returns,

assist taxpayers, collect taxes due, audit returns, and provide all the services required for fair and efficient administration. The cost of administering our system has always been remarkably low--about 50 cents for every \$100 of overall collections during the last 20 years. If voluntary compliance falls, even by a small percentage, the cost of recouping the revenue loss becomes exorbitant.

IRS does not now have all the resources that it needs to administer the tax system fairly and effectively. We are convinced that the Gramm-Rudman provisions, if applied to IRS, will exacerbate an already bad situation.

Gramm-Rudman reductions will affect every IRS activity. Returns processing will be slowed because there will be fewer people and machines to enter information into the system. Errors will not be corrected, correspondence will go unanswered and taxpayers will not receive timely refunds. Taxpayer service will decline, fewer returns will be audited and fewer delinquent accounts collected. All of this because of cuts mandated by Gramm-Rudman.

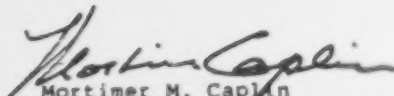
We are distressed that IRS' examination level is now down to 1.2% of returns filed. In 1975 it was 2.56%. These cuts in the Service's programs will result in revenue shortfalls many times the budget reduction.

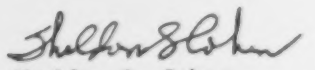
There is no question that every dollar spent by IRS produces many times over direct, immediate cash returns for the Government. On the average, IRS compliance activities produce a direct benefit-cost ratio of at least 10 to 1--for every \$1 spent, \$10 is produced. Over a 5-year period, the estimated reductions to the IRS budget would total \$1.335 billion. This would result in a revenue loss of at least \$15 billion--without even taking into account the ripple effect that lowered enforcement has on taxpayer compliance. The net direct loss would exceed \$14 billion.

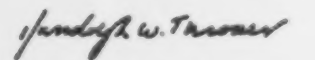
Cuts to IRS' budget are false economy. At a time of budget deficits we should be increasing efforts to attack the underground economy and make our tax system produce the revenue it was designed to raise. With adequate IRS resources and proper use of them, tax collection could be increased markedly with no changes at all in the tax law. We would simply be collecting more revenue from those who should be paying their fair share but aren't. This is not a time for arbitrarily reducing the very work force which can assist in reducing the budget deficit.

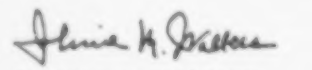
All of us are more than willing to work with you to make sure the IRS is operating to its utmost efficiency and effectiveness, but we entreat you to find some method of adequately funding the IRS so that it can do its assigned job--collecting the revenue to support our Government.

Respectfully,

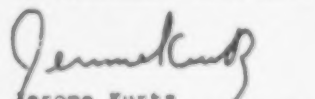

Mortimer M. Caplin
Commissioner 1961-1964


Sheldon S. Cohen
Commissioner 1965-1969


Randolph W. Thrower
Commissioner 1969-1971


Johnnie M. Walters
Commissioner 1971-1973


Donald C. Alexander
Commissioner 1973-1977


Jerome Kurtz
Commissioner 1977-1980

cc: The Honorable Ronald Reagan
The Honorable Robert J. Dole
The Honorable Thomas P. O'Neill, Jr.

American Bar Association

SECRETARY
William H. Neukom
1500 First Interstate Center
Seattle, WA 98104

WRITER'S DIRECT LINE
312/988-5152

RECEIVED

MAR 27 1986

Ways and Means
Subcommittee on Oversight

March 14, 1986

Honorable Daniel Rostenkowski
Chairman, Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

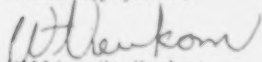
RE: CRS Funding

Dear Mr. Chairman:

At the meeting of the House of Delegates of the American Bar Association held February 10-11, 1986, the attached resolution was adopted upon recommendation of the Section of Taxation. The action taken thus becomes the official policy of the Association in this matter.

This resolution is transmitted for your information and whatever action you may deem appropriate. Please do not hesitate to let us know if you need any further information, have any questions or if we can be of any assistance.

Sincerely yours,


William H. Neukom

WHN:det
Attachment
1623f/1810k

cc: Hugh Calkins, Chairman
Section of Taxation
Robert D. Evans, Esquire
Mmes. Barbara H. Jarr
Christine Brunswick

750 NORTH LAKE SHORE DRIVE, CHICAGO, ILLINOIS 60611
TELEPHONE (312) 988-5000

REPORT NO. 302

RESOLVED, That the American Bar Association recommends to the Executive Branch and to the Congress that the Internal Revenue Service be provided with adequate funding and personnel to assure quality performance by the Internal Revenue Service of each of the functions comprising its mission without undue intrusiveness; and

FURTHER RESOLVED, That the Section of Taxation is authorized and directed to urge the appropriate agencies of the Executive Branch and the appropriate committees of the Congress to provide the Internal Revenue Service on a continuing basis with funding and personnel adequate to those ends.

SEVENTY-NINTH CONGRESS

DAN ROSTENKOWSKI, ILLINOIS, CHAIRMAN

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COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES
 WASHINGTON, DC 20515-6348

June 11, 1986

The Honorable Edward R. Roybal
 Chairman, Subcommittee on Treasury,
 Postal Service and General Government
 Committee on Appropriations
 U.S. House of Representatives
 H-164 The Capitol
 Washington, D.C. 20515

Dear Mr. Chairman:

On May 12, 1986, the Committee on Ways and Means' Subcommittee on Oversight held a hearing to review the Administration's Fiscal Year 1987 budget proposals relating to the Internal Revenue Service. This hearing marks the third time the Subcommittee on Oversight has examined the adequacy of staffing and funding levels of the IRS under the current Administration. It marks, as well, the third time that we are forwarding to you our recommendation that the Internal Revenue Service's resource level be increased above that provided in the Administration's budget request.

The filing season problems of 1985 and the current funding crisis, which has necessitated the urgent supplemental appropriations request for FY 1986, set forth the stark reality of an inadequately funded IRS. Rather than pointing fingers at who's to blame, the time has come for the Congress to take a leadership role in rebuilding IRS into a first-class agency that effectively and fairly administers our federal tax system and collects revenues. It is our hope that the Administration will join the Congress in making such a commitment to ensure an optimally funded and functioning Internal Revenue Service.

As you are well aware, the FY 1987 budget request for IRS provides for 95,084 positions and \$4,097.8 million to administer this Nation's tax laws. This proposed budget level is 3,008 positions and \$194.5 million less than IRS initially proposed to the U.S. Department of the Treasury, and 285 positions and \$22.4 million less than the Treasury Department proposed to the Office of Management and Budget. The FY 1987 budget request represents an increase of 1,360 positions and \$271.6 million above FY 1986 levels.

The increases contained in the FY 1987 budget request are insufficient to enable the IRS to keep pace with its obligations in FY 1987. Years of neglect have left IRS unable to efficiently assess and collect taxes legally due and owing the Federal Government, or provide taxpayers with prompt and meaningful service, or, in the final analysis, to maintain and promote voluntary compliance. The following facts contained in the FY 1987 budget request present particular concern:

- o The FY 1987 budget request is built upon the passage of the FY 1986 urgent supplemental, which is uncertain at this time. If the supplemental is either delayed or vetoed, the FY 1987 budget would fall apart.
- o Although the FY 1987 budget request provides for an increase of 1,360 positions for a total of 95,084 positions, there are 1,708 authorized FY 1986 permanent positions that remain unfilled, and 1,775 estimated unfilled permanent positions for FY 1987.
- o Despite the dismal 1985 tax filing season and the FY 1986 supplemental request of 5,558 positions and \$140.23 million to restore the effectiveness of tax processing, the FY 1987 budget request for Returns Processing and Revenue Accounting calls for a decrease of 1,590 positions and an increase of \$9.40 million. Moreover, in FY 1987 the IRS will process 3.5 million more tax returns and supplemental documents than it did in FY 1986. Finally, service center inventories remain alarmingly and unacceptably high. By late April, 1986, correspondence and adjustments inventories had reached 1.1 million, unpostable inventories had reached 1.6 million, and by March 31, 1986, accounts receivable inventories had reached \$45 billion.

- o Despite the possible reduction in (or cancellation of) ADP acquisitions that may result if the FY 1986 supplemental is not timely approved, and the reduction of selected ADP and systems modernization expenditures as a result of Gramm-Rudman-Hollings, the FY 1987 budget request for Computer Services calls for a decrease of 27 positions and an increase of \$39.73 million. This is 143 positions less than the FY 1985 level. Moreover, the wisdom of this resource allocation is highly questionable in light of major computer problems recently experienced.
- o The 1987 budget request emphasizes a major revenue initiative for the examination of tax returns. However, even under this initiative, only 120,000 additional tax returns will be examined, which will ultimately result in assessments of \$829 million, of which only \$600 million is estimated to be collected. Hence, this initiative only brings in an additional \$5,000 per tax return examined. Worse, the audit level for FY 1987 is projected to be only 1.4%, which is less than that for FY 1983 (1.59%) and all prior years.
- o Despite increases in resources, and even with the tax shelter initiative in the budget request, case levels in Appeals and Tax Litigation continue to rise dramatically.
- o The modest increase in resources for Collection constitutes a decrease of 2,064 positions from actual FY 1985 levels. Yet inventories of uncollected tax, i.e., taxes owing and due, remain outrageously high (over \$45 billion as of March 31, 1986), while collected accounts receivable are \$760 million less than actual FY 1985 levels.
- o While the budget request states that the resources requested for Taxpayer Service in FY 1987 would provide the same basic level budgeted in FY 1986, fewer taxpayers (about 4.5 million) will receive direct assistance than in FY 1985.
- o The request points out the need for greater emphasis on the General Enforcement Program (GEP)

"due to the growing amount of activity involving fraudulent tax shelters, questionable refund schemes, offshore banking, tax havens and the need to maintain a strong presence in the illegal tax protester area". However, only a small increase in the number of GEP special agents and tax fraud investigations is called for.

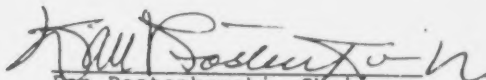
Thus, while deficiencies are most egregious in Returns Processing and Collection, no major IRS function escapes the impact of inadequate resource levels. Moreover, IRS programs, when viewed on a multi-year basis (see enclosure A), appear to suffer from a roller coaster-type allocation of resources. What is increased one year is reduced the next year, on and on, with little, if any, net gain. It seems apparent that greater stability, permanence and recognition of ever-increasing workloads are called for in the IRS budget process, at the very least.

Virtually every witness at the Oversight Subcommittee's hearing recommended that the IRS budget not be viewed solely on an annual basis, but should take into account projections over several years. Witnesses urged that an overall production goal be established followed by a determination of what resource level is needed to achieve that goal.

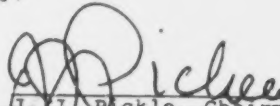
To this end, the Subcommittee asked the Internal Revenue Service to supply information on the maximum capacity of the IRS, in terms of both staffing and funding, to assimilate and absorb additional resources above the levels proposed in the FY 1987 budget request, which could be used effectively and productively to improve tax administration and raise additional revenues. We forward to you the Internal Revenue Service's response, which we believe not only demonstrates conclusively the budgetary deficiencies of the Service, but also presents a realistic productivity goal (see enclosure B). In summary, IRS states that it could assimilate (i.e., hire, train and deploy) 12,490 additional positions over the FY 1987 budget request of 95,000 positions, for \$558 million in additional funding. More than half of these positions would be devoted to improving the processing of tax returns and resolving taxpayer account and tax law inquiries more expeditiously. The remaining positions would be added to direct enforcement effects, predominantly in Collection, for a yield of \$1,764 billion in additional revenue. In addition to personnel, IRS estimates that it would assimilate \$75 million in automated data processing and systems modernization costs.

We believe that the Congress, with the cooperation of the Administration, should begin now to take steps within the framework of IRS's response to ensure that IRS achieves this goal of maximum productivity. This Nation's taxpayers deserve no less. Particular attention should be given in this process, especially for FY 1987, to Returns Processing, Taxpayer Service and Collection.

Sincerely,



Dan Rostenkowski, Chairman
Committee on Ways and Means



J. J. Pickle, Chairman
Subcommittee on Oversight

Enclosures

cc: The Honorable John J. Duncan, Ranking Minority Member
Committee on Ways and Means

The Honorable Richard T. Schulze, Ranking Minority Member
Subcommittee on Oversight

The Honorable Joe Skeen, Ranking Minority Member
Subcommittee on Treasury, Postal Service and
General Government

The Honorable Jamie L. Whitten, Chairman
Committee on Appropriations

The Honorable Silvio O. Conte, Ranking Minority Member
Committee on Appropriations

The Honorable William H. Gray III, Chairman
Committee on the Budget

The Honorable Delbert L. Latta, Ranking Minority Member
Committee on the Budget

A

Internal Revenue Service
Average Positions - FY 1976 to FY 1987

Program	FY 1976	FY 1977	FY 1978	FY 1979	FY 1980	FY 1981	FY 1982	FY 1983	FY 1984	FY 1985	FY 1986	FY 1987	Change FY 1987-FY 1976	% Change FY 1987-FY 1976
Examination	27,817	27,820	26,993	27,173	28,226	26,813	26,710	26,737	27,273	28,353	28,779	31,136	3,319	11.54
Appeals	1,034	1,061	2,259	2,116	1,973	1,894	1,920	2,135	2,312	2,300	2,306	2,844	1,812	55.182
Counsel	1,344	1,352	1,449	1,717	1,672	1,713	1,876	1,873	1,942	1,949	1,972	2,150	592	37.602
Tax Fraud	4,182	3,987	4,144	4,395	4,447	4,347	4,264	4,074	4,074	4,066	4,413	4,440	276	5.402
Collection	12,193	11,259	10,944	11,318	11,266	13,475	14,416	17,222	18,183	17,248	15,140	15,152	2,957	24.232
Info. Rmns. Prog.	1,421	2,226	2,748	2,893	2,943	3,347	3,333	3,410	3,451	4,447	4,942	5,747	4,326	250.772
EPFO	2,272	2,383	2,454	2,537	2,786	2,747	2,817	2,815	2,832	2,818	2,441	2,393	121	5.332
Total Enforcement	51,447	50,322	51,413	51,949	52,823	53,451	54,747	57,544	60,447	61,721	60,145	63,000	12,233	23.675
Tax Processing	28,790	29,425	29,314	29,401	29,405	23,404	19,723	17,915	16,546	19,405	27,466	26,153	16,427	-18.672
Systems Modernization	---	---	---	---	---	---	---	---	---	---	---	---	---	---
Taxpayer Service	4,409	4,876	5,034	5,263	5,333	5,225	4,665	4,274	4,304	4,434	4,714	4,710	2,302	52.242
Others	3,228	3,170	3,348	3,325	3,703	3,596	3,922	3,117	3,483	3,225	2,999	2,959	101	2.192
Total Service	84,264	83,743	85,379	86,146	87,464	86,156	82,357	83,403	87,335	91,259	93,776	95,064	10,820	12.845

001(3)

* Includes Executive Functions, Management Services, Technical Services, Statistical Reporting, and the Help Center.

1) The actual columns of the FY 1978-1987 Congressional Submissions were used.

FY 1976 and FY 1987 were derived from the FY 1987 Congressional Submission.

2) Adjustments were made to the budget structures in an attempt to maintain a consistent classification of the program throughout the years.

3) Resources for the IRP program were extracted from Examination, Collection, Returns Processing, Computer Services, and Taxpayer Service. Prior to FY 1983, the IRP resources represent the best available estimates rather than actual data.

4) Adjustments in FY were made to the FY 1983 - FY 1986 columns to bring the actuals into agreement with 113R report totals.

5) System Modernization includes staff devoted to design and implementation of IRP and system modernization (MIS, DES, etc.). Computer operators at IRS service centers are, however, included under Tax processing.

PH:JDF:JLB
May 7, 1986

B

COMMISSIONER OF INTERNAL REVENUE

Washington, DC 20224

MAY 29 1986 RECEIVED

Honorable J.J. Pickle
Chairman, Oversight Subcommittee
House of Representatives
1105 Longworth House Office Building
Washington, DC 20515

MAY 29 1986
Ways and Means
Subcommittee on Oversight

Dear Mr. Chairman:

This letter is in response to your May 19 request for information on the Internal Revenue Service's budget. Specifically, you asked the Service to supply an estimate of the maximum amount of resources of both staffing and funding that the IRS could assimilate effectively and productively.

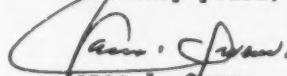
The Service could assimilate -- that is hire, train and deploy -- approximately 12,000 additional positions over the FY 87 budget request of 95,000 positions. Slightly over half of these positions would be devoted to other than direct revenue producing programs. These positions would be devoted to improving the processing of tax returns and resolving taxpayer account and tax law inquiries more expeditiously.

In terms of direct enforcement efforts, the Service could add 3,000 staff years in collection, 500 staff years in appeals and tax litigation, 500 staff years in examination, and 375 staff years in the information returns program. In total, we believe that these direct enforcement programs would yield between \$1.7 and \$1.8 billion. In addition to these enforcement personnel, approximately 800 additional staff years could be added in other enforcement areas, such as Criminal Investigation and compliance research. However, the IRS does not have yield data for these other enforcement activities. Details on the total staffing allocations are set forth in Enclosure A to this letter. To assimilate this volume of new positions, particularly in district offices, authority to hire would have to be received in advance of the fiscal year to cope with recruiting, space, and other significant logistical problems.

In addition to personnel, the Service estimates that it could assimilate \$75 million in automated data processing and systems modernization costs.

A summary description of these initiatives and their effect on the tax administration system is set forth in Enclosure B. I hope this information is responsive to your request.

Sincerely yours,



James I. Owens
Acting Commissioner

Enclosures

Department of the Treasury Internal Revenue Service

INTERNAL REVENUE SERVICE
ADDITIONAL RESOURCES WHICH COULD BE ASSIMILATED IN FY 87
ABOVE THE PRESIDENT'S BUDGET REQUEST
(DOLLARS IN MILLIONS)

	SALARIES & EXPENSES		PROCESSING TAX RETURNS		EXAMINATION & APPEALS		INVESTIGATION, COLLECTION & TAXPAYER SERVICE		TOTAL		ADDITIONAL REVENUE COLLECTED OR ACCELERATED
	FTE	DOLLARS	FTE	DOLLARS	FTE	DOLLARS	FTE	DOLLARS	FTE	DOLLARS	
FY 1987 PRESIDENT'S BUDGET REQUEST	2,844	895.1	27,327	81,262.9	38,974	81,683.2	26,739	81,136.6	95,884	84,897.8	
ADDITIONAL RESOURCES:											
PROCESS TAX RETURNS			5,488	188.8			1,548	70.8	5,488	188.8	8125
TAXPAYER SERVICE									1,548	70.8	
SUB-TOTAL: BASIC RESPONSIBILITIES			5,488	188.8			1,548	70.8	6,988	258.8	
SERVICE CENTER EXAMINATION OFFICE AUDIT					188	3.8			188	3.8	23
					488	13.8			488	13.8	52
SUB-TOTAL: EXAMINATION					588	16.8			588	16.8	
EMPLOYEE PLANS					125	5.8			125	5.8	478
APPEALS & TAX LITIGATION					588	20.8			588	20.8	
TAX FRAUD							585	38.8	585	38.8	
COLLECTION											
ACCOUNTS RECEIVABLE							2,888	98.8	2,888	98.8	738
DELINQUENT RETURNS							1,888	48.8	1,888	48.8	284
INFORMATION RETURNS *			375	15.8					375	15.8	168
COMPLIANCE RESEARCH					258	18.8			258	18.8	
SUB-TOTAL: ENFORCEMENT			375	15.8	1,375	51.8	3,585	168.8	5,335	226.8	81,764
STATISTICS OF INCOME INSPECTION			58	2.8			125	5.8	58	2.8	
TOTAL STAFFING			5,985	197.8	1,375	51.8	5,218	235.8	12,498	483.8	
ADP AND SYSTEMS MODERNIZATION											
TOTAL ADDITIONAL RESOURCES			5,985	628.8	1,375	61.5	5,218	235.8		75.8	
GRAND TOTAL	2,844	895.1	33,232	81,581.4	48,349	81,664.7	31,949	81,394.6	187,574	84,655.8	

* THE SERVICE COULD ASSIMILATE AN ADDITIONAL 1588 POSITIONS IN THE INFORMATION RETURNS PROGRAM, EFFECTIVE JULY 1, 1987. THIS RESULTS IN A FTE COMPUTATION OF 375.

INTERNAL REVENUE SERVICE
EXPLANATION OF ADDITIONAL RESOURCES WHICH COULD BE ASSIMILATED
IN FY 87 ABOVE THE PRESIDENT'S BUDGET REQUEST

PROCESS TAX RETURNS

5,480 positions and \$180 million

The Service could assimilate additional resources in its ten service centers. These additional resources would be used to:

- compensate for the continued decline in our ability to attract and retain a seasonal workforce;
- provide fully for the training of new and experienced employees;
- maintain quality improvement efforts begun in FY 1986;
- ensure timely posting of data from tax returns and payments to accounts;
- continue to reduce unpostable and adjustment inventories;
- provide better communication with taxpayers by improving correspondence procedures and practices;
- provide assistance to tax enforcement programs (e.g. pulling returns) and undertake expanded document matching (for example; matching amounts of withheld tax against employer quarterly returns, tracking deferred adverse tax consequences, etc.), which would result in \$ 125 million in additional revenue; and
- process increased volume of currency and cash transaction reports.

TAXPAYER SERVICE

1,500 positions and \$70 million

The Service could assimilate additional resources to assist taxpayers in meeting their filing responsibilities and in resolving their concerns on the status of their tax accounts. The additional 1,500 positions would be applied to telephone answering and would achieve an 85 percent level of service. Some 15 million additional taxpayers would be assisted.

INTERNAL REVENUE SERVICE
ADDITIONAL TAX ENFORCEMENT RESOURCES FOR FY 1987

EXAMINATION 500 positions and \$16 million

The Service could assimilate an additional 500 positions (above the 2,500 position increase in the President's FY 1987 budget) which would be devoted to:

- conducting correspondence examinations at the service centers involving issues such as unallowables, self-employment tax, multi-filers, etc. collecting an additional \$23 million in FY 1987 (100 positions);
- examining individual tax returns in the district offices thus increasing revenue collections in FY 1987 by \$52 million (400 positions);

EMPLOYEE PLANS 125 positions and \$5 million

The Service could assimilate 125 additional positions to reduce the backlog of requests for determination letters for employee plan as well as master and prototype plan sponsor amendments required by recent legislation (TEFRA, DEFRA & REA) (125 positions).

APPEALS & TAX LITIGATION 500 positions and \$20 million

The Service could utilize an additional 500 positions to :

- settle and litigate over 3,000 cases involving \$100,000 or more in potential tax liability (200 positions);
- settle and litigate 6,500 cases involving \$10,000 - \$20,000, primarily individual tax returns, currently in inventory and flowing from the increased correspondence and district office examinations (300 positions).

By closing these cases, the Service would accelerate collection of tax revenues by \$470 million in FY 1987.

TAX FRAUD 585 positions and \$30 million

The Service could devote an additional 585 positions toward investigating cases involving foreign transactions and bank accounts which have potential for large amounts of unreported tax liabilities. .

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COLLECTION

3,000 positions and \$130 million

The Service could assimilate an 3,000 additional positions in FY 1987 to devote to:

-- collecting taxes owed but not paid thus reducing the inventory of accounts receivables. About \$730 million would be collected (2,000 positions).

-- examining employment tax returns. These examinations would be conducted by revenue officers in connection with their work on securing delinquent returns from employers. An additional \$204 million would be collected in FY 1987 (1,000 positions).

DOCUMENT MATCHING

375 positions and \$15 million

The Service could assimilate an additional 1,500 positions in FY 1987 to follow-up on all instances of unreported income identified through matching. However, because of the nature of the processing cycle the Service would not be able to effect this increase until July 1, 1987 thus realizing only 375 Full Time Equivalent (FTE). The additional resources would increase revenue collections annually by \$348 million, of which \$160 million would be collected in FY 1987.

COMPLIANCE RESEARCH

250 positions and \$10 million

The Service could assimilate an additional 250 positions to increase research in tax compliance.